Economic Research note

US automakers still spinning their wheels

- **Even with the recently announced production cuts, motor vehicle assemblies are set to rise 30% saar in 2Q**
- **The legal status of two of the Big-3 doesn't necessarily have first-order economic significance**
- **Rising imports and lower auto sales, however, imply structural weakness in US auto output**

The economic recession has, as usual, hit the auto industry especially hard. Following an extended period of severe financial problems and eroding market share for the large domestic manufacturers, two of the Big-3 now require government support to keep operating. Both firms are in the process of substantial restructuring that will continue in or out of bankruptcy, and result in firms that are appreciably smaller and with a combination of the unions and the government owning a majority of shares.

Moreover, both firms still face a substantial inventory overhang, leading them to push back the scheduled return to higher production levels. The recently announced idling of plants will reduce 2Q output relative to what it would have otherwise been, but nonetheless motor vehicle assemblies should still be up at an annual pace of 30% this quarter, adding about 0.5% point to GDP growth. The increase comes off extremely depressed lows and reflects the gradual normalization of production at transplants—US-located factories of foreign automakers. Were it not for the idlings announced over the past 10 days, the contribution of motor vehicle output in 2Q could have been well over 1.5% points.

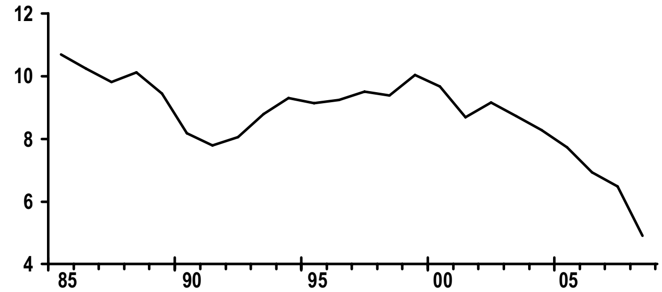
The possibility that the carmakers may enter bankruptcy does not necessarily imply that production will decrease. In some cases, bankruptcy protection can be supportive of economic activity. In the event, regardless of legal form, automakers in the US are unlikely to see assemblies return to their past peak, as transplants will only handle a portion of the demand that is leaving the Big-3, and auto sales may remain low for quite some time.

A sharp drop in Big-3 output

Even a casual newspaper reader knows that production of cars and light trucks by the Big-3 domestic producers has plummeted this decade, sliding from production averaging 9.3 million vehicles per year between 1985 and 2000 to

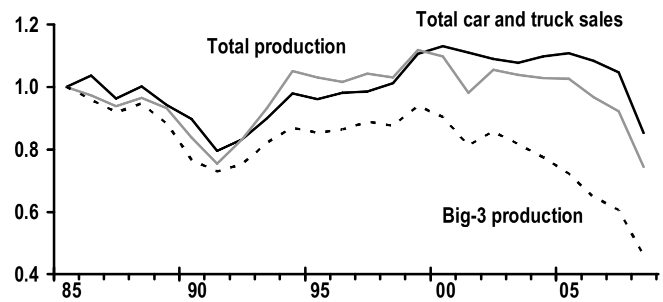
US production of cars and trucks, Big-3 US-based firms

Mn units, saar



US car and truck sales and production

Index, 1985=1.00; annual data 1985-2008



Auto assemblies, including schedules for future production (sa)

%m/m unless otherwise noted

	Total	Cars	Trucks
Jan	-42.0	-54.8	-31.9
Feb	24.7	24.7	24.7
Mar	3.8	12.7	-0.9
1Q (%ch, q/q saar)	-84.5	-94.4	-68.8
Apr	20.7	35.1	12.2
May	-27.6	-20.7	-32.5
Jun	-4.1	-2.6	-5.4
2Q (%ch, q/q saar)	29.9	216.2	-28.1

Actual data through March. Source: Fed. Res., Ward's, company reports.

only 4.9 million vehicles last year. US output fell much further in 1Q09 as automakers slashed production to work off inventories. Since the cost of retiree pension and health benefits is spread across a smaller number of vehicles, the squeeze on profits of the Big-3 has been especially large. Foreign firms operating transplant facilities tend to have fewer retirees relative to current employees and less generous benefits, so the financial squeeze on the transplant firms owing to the recession has been less severe.

Big-3 production in 2008 was 54% lower than it was in 1985; several factors have accounted for the decline. Part is from the recession-related drop in sales. Part is from increased import penetration. And part is from the Big-3 losing share to foreign firms that are assembling at transplant facilities in the US. In 2008, car and truck sales were 15% below their 1985 levels, accounting for less than one-third of the decline in Big-3 production (second chart). Total US production was 25% below 1985 levels, indicating that the combination of weaker sales and increased net imports account for less than half the drop in Big-3 output.

A very substantial part of the Big-3's problems is the increasing market share of US transplant facilities, up from only 8% of US vehicle production in 1985 to 43% of US vehicle production in 2008. The largest transplant firms in terms of US assemblies were the three largest Japanese automakers, which produced a combined 2.3 million cars and trucks in the US in 2008, and accounted for over 60% of all transplant production.

Plenty of spare capacity

The two government-assisted automakers probably will take substantial capacity out of the system in order to reduce costs. Several car lines that were once iconic names in the American auto industry are slated to be eliminated.

In the meantime, there is still plenty of capacity left in the US. The Fed's measure of capacity utilization shows the operating rate in motor vehicles and parts averaging only 60.8% in 2008, falling from a depressed 67.7% in 1Q08 to only 41.0% in 1Q09. The 1Q09 reading was a new low for this series, dating back to 1948, that had averaged nearly 80% between 1948 and 2000.

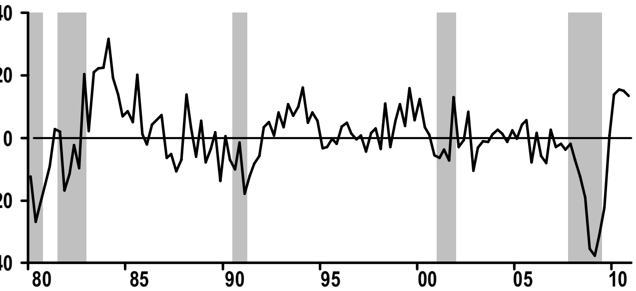
Operating rates in coming years will depend on decisions to remove capacity, on the strength of the recovery in auto sales, and on the value of the dollar and other influences on import penetration. Auto industry consultant CSM, an information source used by J.P. Morgan auto industry analysts, has provided forecasts of annual North American vehicle production by manufacturer. Their best judgment shows a 35% decline in output this year and a gradual return to within 5% of 2008 production levels by 2011. To be sure, most of that improvement they see coming later, as they project 2010 output still 22% below 2008 output.

The boost to growth

The forecast looks for the projected economic recovery to include a 14% increase in unit sales of cars and light trucks next year, a healthy gain for the first year of recovery. There is an argument for an even stronger rebound, as the deep recession of the early 1980s was followed by a vibrant increase in car and light truck sales. However, there are influences that argue for a more gradual rebound this time. Financing is important for the auto market, and credit

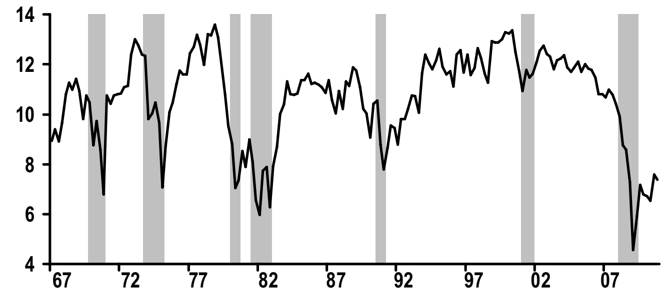
Unit sales of cars and light trucks

%oya, with forecast through 2010



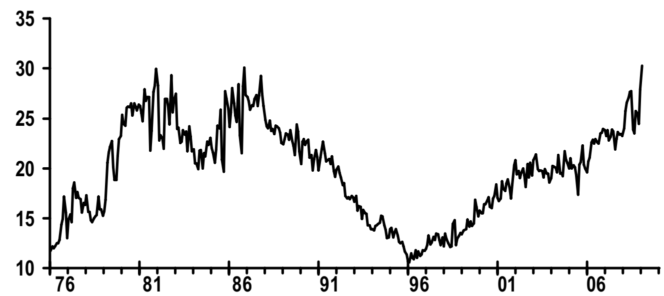
Motor vehicle production

million units, with Ward's forecast through 2010



Import share of light vehicle sales

%



conditions probably will continue to be tight in the early stages of expansion, though the support from TALF probably is helping to ease some of the strains on availability of auto finance.

Probably more important is that cars and light trucks have become much more durable and reliable since the early 1980s. A few years of depressed sales in the early 1980s left the country will an aging (and less reliable) fleet and substantial replacement demand. The same forces will tend to boost sales in the early stage of recovery this time, but increased reliability and durability of vehicles will mean the boost from pent-up demand will probably be smaller.