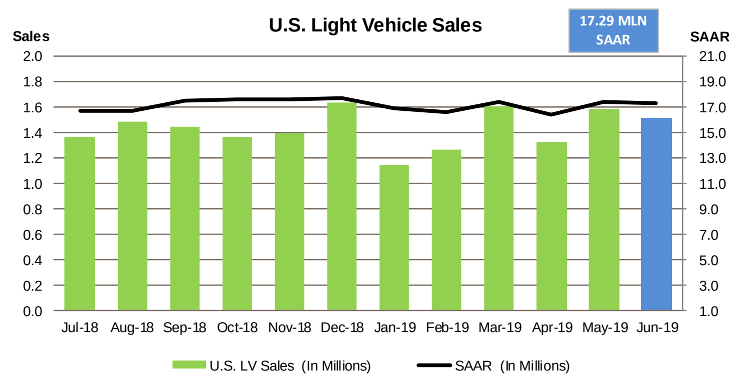
Labor Negotiations Always a "Wildcard"

By Keith Spacapan

The industry recorded its sixth straight monthly decline in June 2019, a cumulative decrease of 2.4% from the prior year. Still, the seasonally adjusted annual rate (SAAR) exceeded 17 million vehicles over three of the first six months of the year. That number was better than anticipated, which now has some industry analysts second guessing what to expect in the second half of the year, particularly if the fed cuts rates as is widely expected. The average interest rate for a new vehicle dropped for the second consecutive month in a row in June, hitting its lowest level so far this year. Edmunds intel says interest rates have been, and continue to be, one of the biggest inhibitors for sales in 2019.



Interest rates are important to dealers as well. Floorplan interest rates have surged from a comfortable 1.5 percent only a few years ago to a current level of more than 5 percent. When interest rates were lower, dealers could afford to carry some additional inventory. After finally falling below 4 million vehicles in May, unsold vehicles ended up in June at 4,004,700 vehicles, a 69-day supply at the current rate of sales. At the industry accepted standard of 60 days, the ideal inventory level would be 3.5 million vehicles. At the current rate of sales, the inventory in excess of the 60 days could be burned off in less than two weeks only if manufacturers stop shipping more vehicles. In practice, and in the absence of an expensive incentive program, adjusting inventory by 500,000 vehicles can take months. And, what happens if the market takes a turn for the worse? When the market collapsed in 2009, vehicle sales plummeted more than 5 million units in a single year. At an annual sales rate of 10 million vehicles for example - which was the run rate at the depth of the great recession - an inventory of 4 million vehicles equates to more than a 115-day supply. And, selling down that inventory may be "complicated" because the industry's rush to build more crossovers and SUVs has resulted in an abundance of light trucks but not enough of the cars that consumers continue to buy. Nearly 30% of all vehicles sold were cars through the first six months of the year but only comprised 25 percent of total inventory on hand.

And, let's not forget that although the UAW has now agreed to extend contracts at Ford, and FCA (Chrysler), the labor contract at GM has expired and workers are officially on strike. All three companies have enjoyed record profitability in the U.S. and, with a potential recession looming, many believe this may be the last chance in some time for the union to extract some meaningful concessions. Prolonged labor strikes can be extremely costly to the industry and disruptive to normal sales. While the companies may be inclined to trim vehicle inventories in the face of an impending recession, carrying additional inventory actually affords the companies a certain level of insurance and leverage against a strike. For the sake of the industry, let's hope the parties involved can come to an agreement quickly.

Finance Cost	Fuel Cost	Inventory	Incentives
6.0% APR	$2.67 per gallon	69 days	$3,747 per vehicle
-7 bp MOM	-$0.10 MOM	+4 days MOM	+$15 MOM
+18 bp YOY	-$0.20 YOY	+0 days YOY	-$38 YOY

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