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US Automotive Market Outlook

Introduction

Looking back, 2013 was a strong year for the auto industry. According to the Bureau of Economic Analysis total new sales were 15.5 million units, up more than 1 million from the previous year and more than 5 million units from the recession low in 2009 (the worst sales year since 1982).

This document looks ahead to consider key factors to watch in the future, including unique trends and statistics that could easily influence the market and drive auto sales higher or lower than industry expectations.

Encouraging signs that support higher-than-expected auto sales

For starters, there is a tremendous amount of pent-up demand. Despite the 15.5 million new vehicles sold in 2013, there remains a huge gap between the number of new cars that should have been sold based on trends prior to the recession and what actually sold. The shaded area in Figure 1 shows this pent up demand. We estimate it to be in excess of 26 million units as of year-end. This is the primary momentum driver in the forecast.
Another positive influence on future auto sales are scrappage rates, which are expected to increase in 2014 as cars continue to age out of circulation.

Consider the life cycle of an automobile. A new car is created and sold or leased. This car is driven for some period of time until it is replaced with a newer model. The car that is replaced is resold and the process continues until the value of the car as a whole is less than the sum of its parts. At this point the car is destroyed for scrap. The ratio of cars that are scrapped to the total cars on the road is called the scrappage rate, and it effectively measures how many cars are removed from circulation in a given year. Generally, the higher the scrappage rate, the greater the number of new cars that will be sold, all else equal.

Another contributor to higher-than-expected auto sales is the combination of a strengthening economy, low interest rates and new technology, which will entice consumers who have been “on the fence.”

Most economists are predicting stronger economic growth in 2014. Unemployment is expected to continue declining, the housing market should continue to pick up and consumer confidence will likely continue to rise. Interest rates for new car purchases remain at record lows with the average rate for near prime consumers around 4 percent. This in and of itself suggests that 2014 will be a good time to buy a new car.

There is another factor to consider, and that is the ongoing inclusion of new technology and new models in the industry. According to LMC Automotive, auto makers are planning to introduce in excess of 130 new models in 2014-2015, more than were
introduced in total over 2009-2011. Features like integrated Bluetooth and rear-view cameras, once only available on luxury cars, are becoming standard on many economy models.

Pay attention to these warning flags that could stall sales

Despite the many positive economic and industry indicators supporting stronger than expected auto sales, there are a few trends that could dampen the outlook if they continue.

To start, auto density has fallen and it can’t get up. Auto density—the number of automobiles per household or vehicles per driver—is one way to measure the demand for automobiles in the United States. Prior to 2006, this ratio was increasing but has been sharply declining since then [see Figure 2]. This is particularly problematic as a small change in this density has a large impact on the number of new cars sold—a 1 percent change in this ratio can equate to as many as 1 million new car sales annually. If this decrease in density is structural and not cyclical, it would present a steep hurdle to growth.

![Density Measured by Number of Vehicles per Household (NSA)](image)

*Figure 2. Source: U.S. Census Bureau; Federal Highway Administration; Equifax*
Here’s another relevant trend to watch. Cars are being driven less and are lasting longer which makes used cars a serious alternative to new cars.

Prior to the recession and based on the previous recession’s experience, conventional wisdom suggested that vehicle sales were unlikely to drop much below 16 million units per year. While this was obviously incorrect, it’s nonetheless understandable when looking at auto sales from 1999-2007. Slicing the data another way, however, gives a more sobering picture. Figure 3 shows the annual number of new cars purchased per 100,000 licensed drivers. As the trend line shows, this rate has been steadily decreasing since 1976, and sales in 2013 are very near their expected value.

![Figure 3. Source: U.S. Bureau of Economic Analysis; Federal Highway Administration; Equifax](image)

Additionally, there has been a decline in the miles driven [see Figure 4], and improvements in the manufacturing process have dramatically improved the quality of cars created thereby extending their reliability. This combination makes it very difficult for a consumer to justify pulling the trigger on a new car compared to either keeping their existing car or going with a low-mileage used car.
The next factor is somewhat sobering. Americans are falling out of love with automobiles. Demographic trends are not moving in favor of the automobile. Urbanization is shifting the population to areas where owning a car is unnecessary—public transportation and ride share services like ZipCar are a more cost effective way to satisfy the needs of many city dwellers.

Surveys, such as those by the University of Michigan’s Transportation Research Institute (UMTRI), have shown that many Millennials—the generation born between the early 1980s to the early 2000s—are much less interested in owning a car than their parents and grandparents, viewing them as nothing more than a way to get from point A to point B. For many, the effects of the Great Recession coupled with increased student loan debt have delayed the purchase of a new car, perhaps indefinitely.

This shift in attitude is not confined to the younger generations. Baby Boomers are beginning to retire and will no longer have the desire to purchase a new car every four years. Car manufacturers are keenly aware of the changing marketplace but it may take time to find and implement a successful strategy.

Last, auto financing demand is rising faster than the demand for new and used cars. More than ever before, consumers are considering the cost of financing a car when making a decision to purchase, and the trends are in their favor. Post-recession, prime and near-prime credit car purchasers have had a fairly easy time finding great deals on car loans, but the offerings have not been as plentiful for those with recent severe credit problems stemming from foreclosures, long-term unemployment or other set-backs.
Auto lenders, particularly non-bank finance companies, are starting to look for ways to expand credit availability to those with less-than-stellar credit. Appetite for auto loan securitizations among Wall Street investors is also showing nascent signs of growth, which may increase access to financing while also creating more demand for detailed data on consumers, their capacity to carry new debt and their credit behaviors.

Conclusion: Sales outlook is good, but guard against evolving barriers to growth

Widen your target audience to include low-risk subprime consumers

While annual auto sales have yet to return to pre-recession highs, forecasts for 2014 are positive, with year-over-year growth expected. What’s more, key economic and industry indicators are showing favorable activity that could push sales above current projections. But, the path ahead is not perfectly smooth as evolving trends, such as the increasing indifference of Millennials and Baby Boomers toward new cars, could threaten long-term growth.

Moving forward, the auto industry should consider expanding its customer base by reaching out to the many formerly prime consumers who were negatively impacted by the 2009 recession. As this population recovers financially in step with the larger economy, it could present new opportunities for the industry. To do this, lenders should consider accessing deeper consumer credit insights—beyond a traditional credit score or report—from alternative data sources such as pay TV and utility bill payments and other sources. By better understanding how consumers pay their fixed bills, auto businesses can more confidently assign risk to more consumers, expand their target audience and grow their customer base and auto sales well into the future.

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