Automotive Demand Improves Again Through February

Demand Index Improves Again

BLUF (Bottom Line Up Front): The NCM automotive index moved up again in February and is now slightly above average over the long-term range. The index came in at 60.7 in February, up 1.4 points from 59.3 in January. This is still historically a stable reading and shows that demand is still better than expected for most models. But, like mentioned last month, the economy is recovering in tough manner with one-third or slightly more households struggling under inflation pressure.

Favorable Economic Conditions:

- **Updated Economic Outlook Positive. –** For now, economic growth is exceeding expectations. If these trends continue, the US should see annual growth of nearly 2%, up nearly a full percentage point from estimates at the beginning of the year. Consumer spending is still trending ahead of expectations and corporate investment is generally remaining stable. There is no question that global geopolitics are weighing on expectations and have started to push some consumers to "bunker" (building cash reserves "just in case"), especially with uncertainties surrounding the election. But overall, the economy continues to be stable on the back of a solid jobs market. Without stable wage growth and employment, conditions would change quickly. And that's the data point to keep an eye on.

- **Real Disposable Income Slips M/M –** There has always been a stronger correlation between unit auto sales and disposable income. Current, inflation-adjusted disposable income grew at a 1.7% rate through February (slower than January's 2.1% rate). This is a slower rate than we saw over the past year (the 2023 average was 4.2%), but it is still positive when stripping out the impact of inflation. Consumers in general will still feel that they have capacity to spend, and their total income will still be growing based on this data. For the full year, economists expect disposable income to grow at just 1.4% in both 2024 and 2025, down from last year's rate of 4.2% as mentioned.

- **Interest Rate Questions Remain.** Just when it looked like the Federal Reserve would be poised to start cutting interest rates, the economy threw some curve balls at it. In the latest report from the Fed in March, expectations still hold for up to three, quarter-point cuts in 2024. The first quarter-point cut was projected to come as early as June, but those notions are starting to fade. Stronger than expected economic growth, sticky inflation, and a strong jobs market could keep the Fed in place longer. For now, most analysts still project that interest rates will move from a Fed Funds rate of 5.25% to 4.75% by the end of the year. Good news is that banks are lowering their standards for auto loans, only 6.3% were tightening standards at the end of Q1, the lowest rate since Q4 of 2022.

Risks Creating Headwinds for Vehicle Sales:

- **Pro/Con Rising Fuel Costs.** – Gasoline prices have risen by 20 cents a gallon in just the last thirty days, and with petroleum prices rising, they could go higher before long. There was an adage that rising fuel prices were good for some auto sales, to a point. Rising fuel prices can sometimes pull consumers driving older vehicles (with poor mpg) back into the market for a more fuel-efficient model. Of course, the downside is multifold. First, it may push some buyers of higher-margin SUVs or trucks into more economic models. Second, it keeps some buyers completely out of the market because they won't compromise and believe that hanging onto an older vehicle and managing repairs is still cheaper. In any event, fuel prices are rising and if petroleum price projections are accurate, we could see gas prices closer to $4.00 a gallon. That would change consumer spending patterns.

- **Concerns About Input Costs.** Inflation has been a factor for some time since the pandemic started, but prices have been generally easing over the past year. However, March manufacturing reports suggest that input costs may be going back up for a variety of reasons. That, plus higher manufacturing wage and energy costs, could be a factor in future unit costs (pushing retail prices higher for autos or keeping profit margins tight if consumer pushback prevents selling price increases).

Conclusions:

1. Demand for autos was stable for now amid some growing pressures.
2. Inflation-adjusted disposable income dipped in February and were running at an annual rate of 1.4%. This is weaker than the 4.2% rate from last year. There is a strong correlation between disposable income and auto sales.
3. Countries around the world have begun to report problems arising again in inflationary pressure from higher input costs into the production process.
4. Supply chain challenges are also still hampering overall output and could affect inventory rebuilding activity in the coming months.

Related Macro Items We are Watching:

1. **Petroleum Prices and Inflation.** At the time of writing, petroleum prices were rising and were up 19.6% year-to-date and were 15.9% higher vs. this time last year. JP Morgan is predicting that oil prices could move above $100 a barrel by July. And when it comes to many commodities, there may not be a more important item shaping global economics.

   Geopolitical issues and recent drone strikes on Russian refinery infrastructure has elevated concerns about global supply. Prior to these events, the EIA had projected supply matching demand for most of 2024 and into 2025. With China's economy perhaps performing a bit better than expected, some strength in India and slight improvements in Europe, demand projections could be moved upward. And with hits to production raising concerns of global oil supply, it is pushing overall oil price expectations higher. As mentioned, for now.

   Lastly, there is some risk in trying to predict the weather, but the hurricane forecast for 2024 is ramping up to be one of the most active in recent history. With warm Gulf and Atlantic waters coupled with a shift to La Nina (which changes upper wind currents and reduces wind shear), the number of US landings has the potential to be higher. Gulf oil production has been unimpeded for several years, and that could change this year. This would also push oil prices higher. If a strong storm were to make landfall in the Gulf region, it would push refined fuels and petroleum prices higher. Oil prices surged 39% in the three months after Katrina in 2005.

NCM Automotive Demand Index

Index Moves Up Again in February

BLUF (Bottom Line Up Front): the **NCM Automotive Demand Index (ADI) improved again in February.** The current index (at 60.7) was showing vehicle demand ahead of the long-term average of 57.4 points. As mentioned last month, this index measures demand, based on economic metrics that generally drive consumer spending and the need for new vehicles. The trend is positive despite some pressures on consumer spending (higher interest rates across all types of debt instruments, high rent costs, resumption of student loan payments, etc.).

NCM ADI:

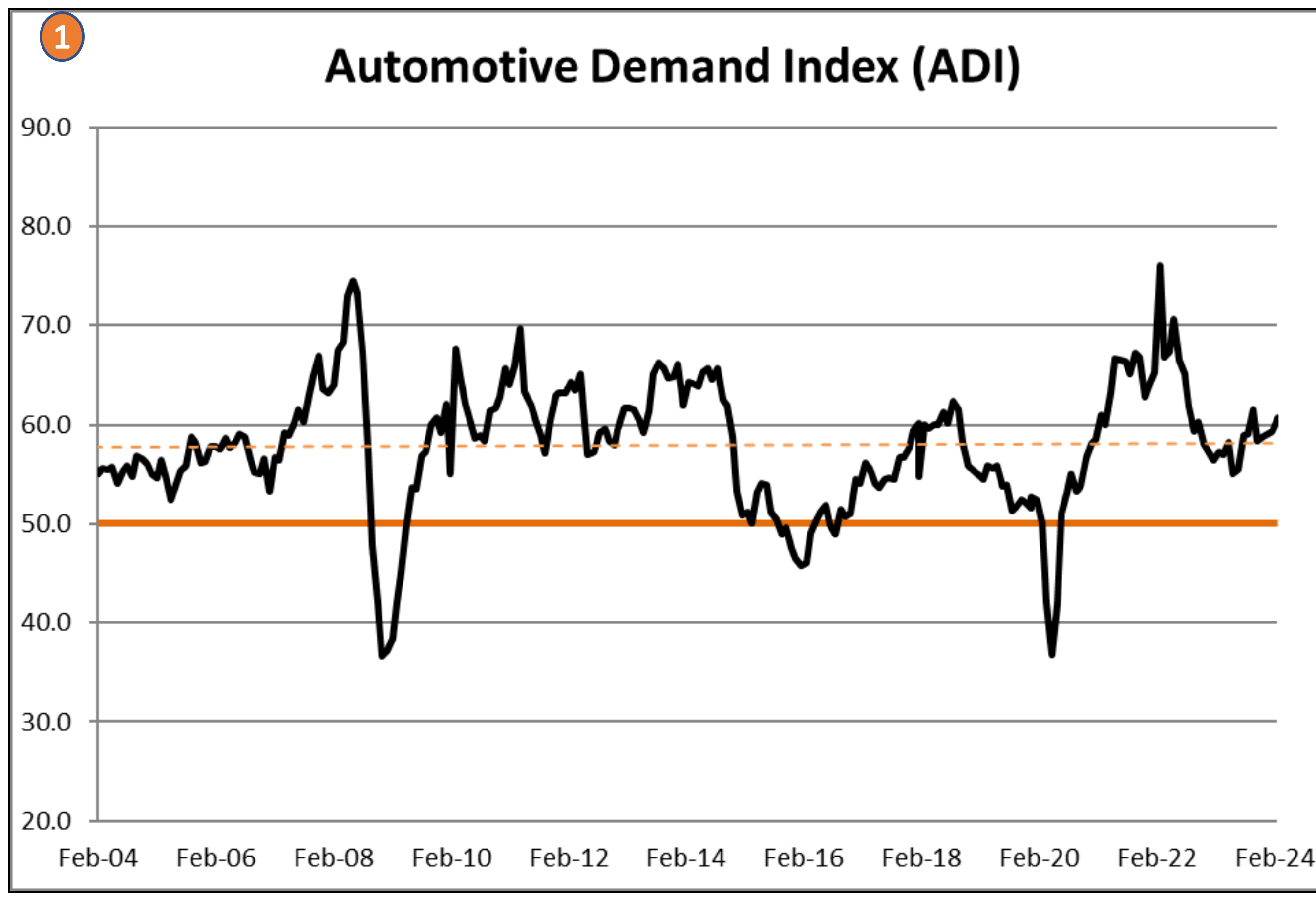
• February	60.7
• January	59.3
• December	57.3
• November	58.8
• October	58.4
• September	61.5
• Aug	59.0
• July	58.9

Primary Impacts on the Automotive Sector:

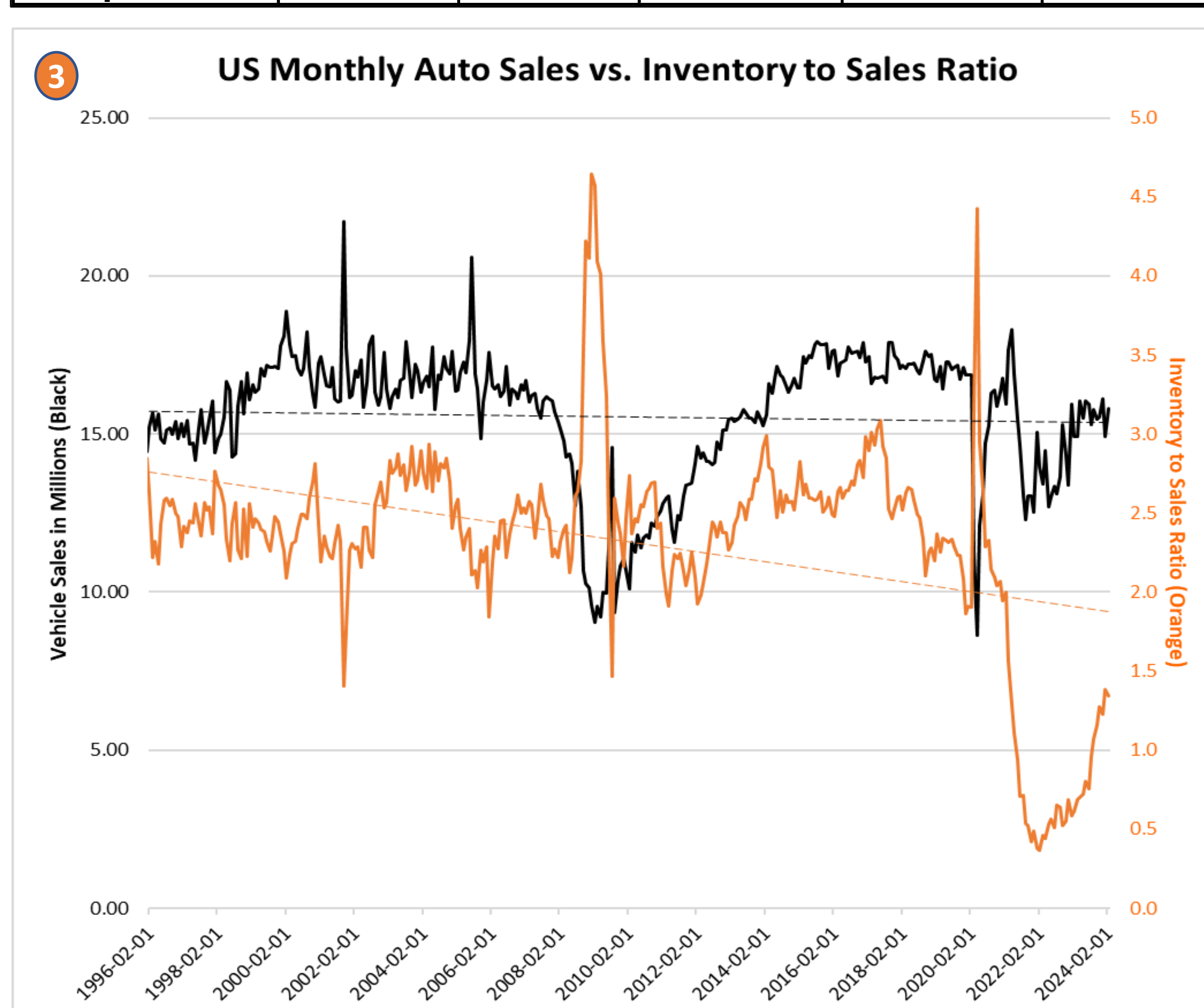
- **February ADI Comes in at 60.7.** The NCM ADI came in at 60.7, up 2.4% vs. the January reading of 59.3. And the index was 6.1% higher than it was last year at this time. The index is now slightly above the 20-year range illustrated by the dotted line in the chart at right. But relative to prior periods, demand is now considered to be "average".

- **Inventories Rebounding.** Light weight vehicle sales were trending at 15.795 million units (annual rate) in February (latest available), this was 5.9% higher M/M from January, and was 6.2% higher Y/Y. The inventory to sales ratio was 98.5% higher Y/Y against extremely weak inventory levels from a year ago (orange line in the graph below right). Historically, it is still 29.5% lower than levels prior to the pandemic (28.5% last month). Inventories are still too low, relative to sales. But the industry is showing progress and recovery and hints of oversupply later this year is seeping into conversations.

- **What is Pulling on the ADI?** The ADI uses 18 different economic metrics to gauge consumer demand and several factors were pushing or pulling on it this month. Remember that the ADI measures general demand, but conditions could exist that might limit some buyers from being able to finish a purchase. The index incorporates financial data to measure consumer strength, and segments of US households are still financially improving their personal status – while some at the opposite end are struggling.



2	24-Feb	23-Jan	23-Feb	Y/Y Change %	M/M Change %
Composite	60.7	59.3	57.2	6.1%	2.4%



Looking Forward:

- **Update on the K Shaped Growth Trend.** This was mentioned last month and became more pronounced over the past 30 days. The US is clearly now going through a 'K' shaped economic growth process.

  Those households in the upper and upper middle-income categories have significant disposable income, strong savings, and are riding income from good stock market performance and these households are willing buyers of higher end vehicles. This is why some larger ticket vehicles are still selling – and will continue to sell throughout 2024.

  But the middle income and lower income households are under intense inflation pressure, have soaring debt, and they are effectively getting shut off from big-ticket or debt-reliant purchases. More than 55% of middle-income households and 85% of lower-income households are still living check-to-check.

  Inflation, automation, and competition from new job entrants are pressuring this segment of workers. That being said, middle-income and upper-income households reported in February that they were "job jumping" still and 10% gains in income were resulting from that trend. These are good vehicle-buying segments.