

Research Department
Federal Reserve
Bank of
San Francisco

November 30, 1979

Mourning in Motown

The tenth largest U.S. industrial corporation will probably lose a billion dollars or more in 1979. The third largest industrial corporation will probably lose a like amount on its domestic operations alone—although luckily, it can balance its books with profitable operations elsewhere. The important point is that these two firms (Chrysler and Ford) are key elements in an industry which has long typified the power and efficiency of the American economy. Their plight suggests the need for a searching examination of the industry which directly or indirectly supports about one-sixth of the American workforce, and which sets the tone for American lifestyles as well.

Problems: cyclical, secular

New-car sales are in the midst of a cyclical downturn, with sales off about 4 percent this year from the year-ago level. Some weakness could be predicted, following as it does the sales upsurge of the 1976-78 period. However, the record is considerably worse when import sales are excluded. Sales of U.S.-produced autos have dropped 9 percent in 1979, to an 8.7-million annual rate for the first three quarters of the year. At that level, domestic sales are not much higher than they were a decade ago, whereas import sales (at a 2.3-million rate) have more than doubled over that same time-span (see chart). Moreover, new-car inventories are higher now than at any time since the dismal days of 1974. At a time of year when inventories normally would be at their lowest because of new model introductions and the resulting sales upturn, the domestic industry was burdened by a 65-day supply on November 1, compared with a 48-day stockpile a year earlier.

The industry's problems may be more than cyclical, as the record of import penetration suggests. Admittedly, ever since the Duryea brothers founded the industry in 1893,

Detroit has shown an admirable ability to produce cars and above all to "move the metal." This year, Detroit produced its 300 millionth passenger car, as well as its 75 millionth truck. In the process, it has provided Americans with their most important consumer durable; the \$251 billion worth of autos (net of depreciation) which consumers held at year-end 1978 accounted for about 35 percent of their total holdings of durable goods. But as it enters the 1980's, Detroit must decide whether the market is becoming saturated (at least, saturated with American products)—or whether consumers will be willing to buy the much-improved models of the coming decade. (A separate question is how much fuel will be available to propel those models.)

Paying for today's autos

The weakness in the industry's near-term sales outlook reflects the weakness of the consumer's income situation, as well as the growing demands by other sectors for the consumer dollar. Total real disposable income in the January-September period was 3.0 percent above the year-ago figure—only about two-thirds the annual gain of the several preceding years—and the average worker's real spendable earnings have actually declined. Moreover, with the sharp rise in prices of more essential items, consumers are hard-pressed to find enough dollars to spend on autos. Compared with a decade ago, for example, auto spending as a share of consumer disposable income has dropped slightly, from 6.0 to 5.9 percent, whereas the housing share has risen from 13.8 to 14.7 percent, and the energy share has jumped from 6.3 to 7.8 percent.

Auto sales have benefited considerably from heavy infusions of credit during the past several years—auto buyers borrowed \$93 billion (annual rate) in the first half of this year, or double the 1974 pace. But the lending pace has already slowed, and with the

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recent tightening of credit, the industry can't count on further sales boosts through easy credit. Certainly there seems to be little room for further lengthening of maturities on auto loans. In 1974, finance companies wrote contracts with maturities of over three years for only 9 percent of their new-car loans, and for practically none of their used-car loans; in 1978, they offered lengthy maturities for 57 percent of their new-car loans and even for 22 percent of their used-car loans.

Enough autos?

Assuming reasonable fuel availability, we can expect that Americans will continue to rely heavily on the private auto for transportation. About 85 percent of all Americans now ride to work in their own autos or in carpools. And they use cars, trucks or taxis for about 91 percent of all working, shopping or recreational trips. Still, they appear to have enough vehicles to handle their needs. About 84 percent of all households own at least one car—the proportion rises to 96 percent for those with over \$12,000 income—and 36 percent of all households own two or more cars.

Under these conditions of relative saturation, further sales growth depends on the growth in the number of younger drivers—and on the growth in the number of aged cars, i.e., those ready for the scrap heap. Probably not much can be expected from the demographic front. The increase in the number of individuals in the 20-34 age bracket will be only about 2 million during the 1980's, compared with a gain of almost 15 million in the 1970's. On the other hand, replacement demand can be expected to provide strong support for the industry

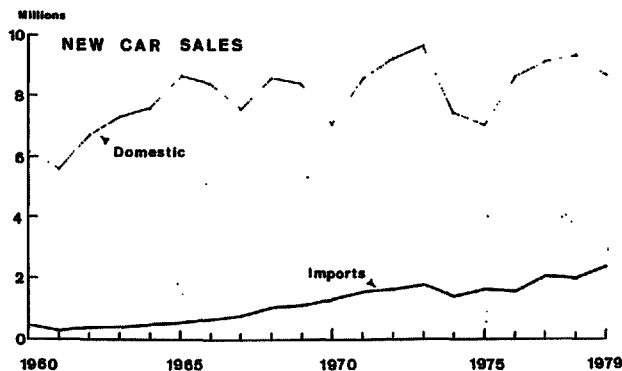
in coming years; 8.2 million cars were scrapped in 1977 alone. Of course, effective demand could weaken if drivers postpone junking their older cars, as has happened throughout the 1970's—the proportion of older cars (six years or older) has jumped from 39 to 47 percent of the total between 1970 and 1978.

The sharply rising cost of owning and operating a car might help account for this growing tendency by drivers to postpone new purchases. According to a recent study by the Hertz car-rental firm, ownership and operating costs rose from 33 to 38 cents a mile over the past year—and altogether, jumped 88 percent between 1973 and 1979, compared with a 63-percent rise in the overall consumer price index over that period. Indeed, motorists now pay more to run a subcompact car than they paid to operate a full-sized luxury model in 1973.

Tomorrow's autos

Detroit of course has been working strenuously to reduce ownership costs through increased attention to fuel efficiency, reflecting industry (and Congressional) fears about the availability as well as the price of Middle Eastern oil. The industry obtained its mandate from the Energy Policy and Conservation Act of 1975, which calls for a rise in fleet-average fuel economy to 27.5 miles per gallon for the 1985 model year. That 113-percent projected rise in fuel economy over the 1974 performance has already resulted in dramatic product changes. The new generations of "down-sized" vehicles are as much as 1,000 pounds lighter than their predecessors, and many of them feature thriftier powerplants, lighter materials, and electronic engine controls. By 1985, the average car could be 25-percent lighter than its current counterpart, weighing in at only about 3,000 pounds, and it could incorporate 50 percent more aluminum and plastic than today's model.

During the 1970's, the industry has made substantial advances in meeting Congress-



sionally imposed fuel-economy standards, along with safety and anti-pollution standards. The fuel economy of passenger-car fleets has already surpassed the industry's original goal of a 40-percent improvement over 1974-fleet standards. Traffic fatalities per 100 million vehicle miles have continued their historical downtrend, declining from 5.40 deaths in 1968 to 3.41 in 1978. And today's cars emit 86 percent fewer hydrocarbon emissions, 82 percent less carbon monoxide, and 51 percent less nitrogen oxide, than the uncontrolled 1967 models.

Yet meeting the even more stringent standards of the 1980's will require, by the industry's calculations, the greatest retooling of a single industry ever undertaken in the nation's peacetime history. The required investment will reach \$70 to \$80 billion over the 1978-85 period—twice the bill for putting a man on the moon, as industry spokesmen frequently remind Congressional listeners. Chrysler, for one, has found it impossible to finance its investment needs internally—hence its request for a \$1.5-billion government-loan guarantee—and the industry generally will have to pass these unprecedented costs along to the consumer in the form of much higher sticker prices in the early 1980's.

Tomorrow's market

The problem would be eased if Detroit could take advantage of efficiencies of scale, with lengthy production lines for their 1980-85 models. But increased sales may not come easily. Faced with higher auto prices, consumers may hold on to their older (and roomier) cars for longer periods of time, as they have been doing recently—or faced with long lines at the gas pump, they may even become desperate enough to take the bus. But again, if consumers do decide to buy, they might choose the similar appearing but frequently more reliable import model over the Detroit version. The trend of course is already evident; between the 1960's and the 1970's, imports accounted for more than half of the entire

growth (21 million) in new-car sales in the U.S. market.

Detroit's fate, in the final analysis, may be settled as much by foreign producers as by American consumers. Most of the world auto industry is beset by overcapacity, and is intensely protectionist at home and intensely competitive overseas. Most producers are heavily reliant on export sales, especially sales to the American market—the Japanese industry being a case in point. Despite a sharp rise in the value of the yen, Japan in recent years has increased its share, from one-third to two-thirds, of the U.S. import market. This year alone, about 40 percent of all Japanese-produced cars will be sold to American buyers.

Detroit's response involves not only building "import fighters" with fuel economy and other "import" characteristics, but also expanding the American presence overseas, most notably through the development of "world" cars. General Motors' new T-car, for example, may be built in millions around the world—at Opel in West Germany, at Vauxhall in Britain, at a new plant in Spain or France, at Isuzu in Japan, at Holden in Australia, at other plants in Brazil and South Africa, and of course at Chevrolet in this country. Thus, if Detroit is unable to "move the metal" as it once could in the domestic market, it can at least utilize its world-famed mass-production techniques on a worldwide scale—thereby achieving the necessary economies of scale while maintaining a sales presence in every possible market.

William Burke

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT
 (Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 11/14/79	Change from 11/7/79	Change from year ago @	
			Dollar	Percent
Loans (gross, adjusted) and investments*	135,057	+ 121	+ 16,261	+ 13.7
Loans (gross, adjusted) — total#	112,024	+ 104	+ 15,977	+ 16.6
Commercial and industrial	31,080	- 199	+ 2,924	+ 10.4
Real estate	42,196	+ 217	+ 8,765	+ 26.2
Loans to individuals	23,876	+ 54	NA	NA
Securities loans	1,589	+ 55	NA	NA
U.S. Treasury securities*	7,421	+ 37	- 969	- 15.0
Other securities*	15,612	- 20	+ 1,253	+ 8.7
Demand deposits — total#	45,903	+1,614	+ 2,750	+ 6.4
Demand deposits — adjusted	32,157	+ 296	+ 1,287	+ 4.2
Savings deposits — total	28,893	- 223	- 1,488	- 4.9
Time deposits — total#	57,539	+ 851	+ 9,006	+ 18.6
Individuals, part. & corp.	49,179	+ 837	+ 9,942	+ 25.3
(Large negotiable CD's)	21,465	+ 610	+ 2,432	+ 12.8
Weedly Averages of Daily Figures	Week ended 1/14/79	Week ended 11/7/79	Comparable year-ago period	
Member Bank Reserve Position				
Excess Reserves (+)/Deficiency (-)	+ 37	+ 175	+ 1	
Borrowings	276	+ 201	+ 17	
Net free reserves (+)/Net borrowed(-)	- 239	- 26	- 16	
Federal Funds — Seven Large Banks				
Net interbank transactions	- 389	+ 584	+1,156	
[Purchases (+)/Sales (-)]				
Net, U.S. Securities dealer transactions	+ 208	+ 222	+ 343	
[Loans (+)/Borrowings (-)]				

* Excludes trading account securities.

Includes items not shown separately.

@ Historical data are not strictly comparable due to changes in the reporting panel; however, adjustments have been applied to 1978 data to remove as much as possible the effects of the changes in coverage. In addition, for some items, historical data are not available due to definitional changes.

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