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Doubt in Detroit

The auto industry is encountering more than its share of problems as it enters the 1974 model year—witness the rather somber sales forecasts now being put out by the usually ebullient industry. Auto moguls undoubtedly foresaw a normal cyclical weakness in sales, since 1974 follows on the heels of two model years which were not only record dollar earners, but also represented the strongest back-to-back growth performance of the past several decades. In addition, industry expectations probably included some allowance for the impact of changing consumer tastes and newly-mandated safety and pollution-control regulations. But now Detroit must also take into consideration the massive yet unpredictable Middle East oil crisis—a crisis which strongly affects the industry, since motor vehicles usually account for about half of the nation's total petroleum consumption.

Entirely apart from the oil shortage, Detroit began to have increasing doubts about the strength of the boom even in the midst of its record-breaking 1973 model-year performance. (The model year is defined here as the first three calendar quarters of 1973 plus the fourth quarter of 1972.) New-car sales peaked early last spring at a phenomenal 13-million-unit annual rate, and have since dropped off to roughly a 10-million rate in October. Despite this more moderate sales volume, factory output—even at flat-out production—lagged behind demand until quite recently, when factories began to ease their production schedules in response to growing surpluses of large cars.

The boom

Gross auto product increased 16 percent in the 1973 model year to $49 billion, and accounted for about 4 percent of the nation's total output. (Gross auto product measures the value of domestically produced cars plus the net value added by the distribution of new, used and imported cars.) The boom this year made substantial contributions to the health of many other major industries, since Detroit normally accounts for about one-tenth of the copper, aluminum, and nickel, one-fifth of the steel, two-thirds of the rubber, and three-fourths of the plate glass purchased by the nation's entire manufacturing sector.

Corporations supported the rise in gross auto product with expanded fleet purchases, but the major factor involved was a 14½-percent increase in consumer purchases, following on the heels of an even stronger 18½-percent increase in the 1972 model year. A sharp rise in consumer disposable income fueled the auto-buying spree; income wasn't the whole story, however, since the even-stronger sales gain of the '72 model year was based upon a much smaller increase in income. Another underlying factor was the continued strength of replacement demand, with scrappage in the neighborhood of 8 million units. As for financing, auto-credit extensions jumped 20

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percent in both 1972 and 1973, or several times as much as in any other year of the past decade.

Sales also benefitted from consumers' apparent desire to buy ahead in anticipation of price increases. This was especially true of import sales, which soared last winter when buyers realized that prices would be considerably higher after the February devaluation. (This recent episode was almost a repeat of the sales performance following the defacto devaluation of August 1971.) But higher import prices did little to stem the import boom, except for the lowest-priced foreign models. Indeed, the sales value of foreign cars (boosted by post-devaluation prices) rose 21 percent to $9.8 billion—an amount equal to total import sales during the entire 1960-67 period.

The bust?

Those purchasers who rushed to beat the crowd last year probably will not be in the market this year for a more expensive 1974 model, imported or domestic. Neither will those who are worried about the efficiency of new pollution-control equipment, especially when they are also worried about the price and availability of gas supplies. And potential import buyers might overlook the obvious fuel economies of those models when they realize that low-priced foreign cars are no longer low-priced. (After its fourth price boost this year, Volkswagen's Beetle is now 31 percent more expensive than a year ago.) Detroit's forecasters may well be correct in estimating a decline from 1973's almost 12-million-unit pace to a level of about 11 million units in the 1974 model year.

A more interesting question is what will happen in 1975 and later years. Based on the usual variables of population, income, and average age of the auto stock, the industry's demand equations suggest a strong uptrend throughout most of the decade. Based on a number of imponderable factors that have surfaced within the past few years, they may come up with a somewhat different conclusion.

Many potential buyers increasingly view an automobile as simply a vehicle rather than a status (or sex) symbol. Younger well-educated buyers in particular have become less susceptible to the industry's traditional sales pitch, designed to persuade them to trade up to the limit of their ability. This choice of practicality over glamour is related to the demand for second and third cars, which represent virtually all of the industry's sales growth because of the saturation of the one-car family market. In this second-car market, small low-priced (and low-profit) cars are normally all that is required, which suggests rather somber implications for the industry's dollar value. The household funds that used to go for the purchase of big expensive cars may now be spent for new status symbols, such as boats or vacation homes.

Replacement demand will continue to provide a strong underpinning to the market, however. With the number of cars on the road rising steadily, and with scrappage chewing up about 9 percent of those cars every year, the growth of replacement demand seems almost assured. (In recent years, scrappage has amounted to roughly 70 percent of new-car sales.) A number of individual factors affect scrappage rates, but perhaps the most crucial is the age distribution of the auto stock. By that standard, the scrappage rate (and replacement demand) at mid-decade might approximate 8.5 million units—one million units higher than at the beginning of the decade.

Industry response

Despite the high floor placed under total demand by this level of scrappage, Detroit is not overly optimistic about the 1974 model year, for all the reasons mentioned above. To complicate matters, the industry must face the fact that its recent record-breaking sales performance has not been matched by a comparable profits performance, because of such factors as the Cost of Living Council's skeptical attitude toward price increases and the consumer's growing preference for small, low-profit cars.

Detroit's basic response to these developments is to meet the customer at least partway. All producers have joined in a drive to beef up capacity for smaller cars, in the process slowing down production lines for the gas-guzzling larger cars. But with an eye on profits, the industry is loading up the smaller cars with all the (profitable) options they can carry. The Mustang II, newly unveiled as a cut-down successor to the very successful Mustang of 1965, carries a basic sticker price of $2,895, but fully equipped with options it can run to more than $4,000.

Paralleling these efforts, the industry is heightening its cost-control efforts. It is beginning to adopt major innovations in technology—the Wankel engine being the best example—with the double attraction of reducing both pollution and costs. (Critics argue that Detroit's last major innovation was the automatic transmission, adopted in the late 1930s.) The Wankel rotary has 40 percent fewer parts and is only about half the size of the conventional engine. It is also the only engine presently available that can meet future federal emission standards without prohibitive cost or special gasolines. As another concession to cost control, Detroit is junking long-hallowed but now outmoded modes of operation—in particular, annual and biennial styling changes. (The new dies and tooling associated with an annual model change used to amount to $1.5 billion annually.) With designs of many models all but frozen for perhaps the next five years, we may soon see how much truth there is to Detroit's long-standing belief that frequent styling changes are essential to the industry's sales volume and profitability.

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