

Optimism through All the Negative News

Brian Kennett, Partner
Peterson Sullivan LLP

Every time we open a newspaper or turn on the news these days, we are confronted with yet another headline foretelling the demise of the American automobile industry. December marked another month of declining sales, culminating in the industry's worst year in more than a decade. There is no question that times are tough for dealerships. However, I believe that things might not be quite as dismal as the headlines would lead us to believe. Yes, consumer confidence is down. People have spent that past few months watching their retirement portfolios dwindle and worrying about how far the value of their home has declined. Now, announcements of layoffs and corporate bankruptcies leave some wondering if their job will be the next one on the line.

As dire as things may seem on the national front, the local consequences have not been so severe. I would argue that Puget Sound consumers have only been temporarily sidelined, watching and waiting until they can figure out where they fit into the game. Sooner or later, they will start stepping back onto the field, and I'm guessing that it will be sooner. Initial reports have it that January sales were up, the first monthly increase in some time. As tentative a step as this may be, it is definitely a good sign: it shows that pent-up demand really is there. While it may take a few more months for consumer confidence to take hold, I believe that it will. Here's why:

Uncertainty is on the Wane

First and foremost, the level of uncertainty in economy should start to wane in the months to come. There is always a tremendous amount of insecurity leading up to the inauguration of a new President, and the national economic circumstances at the end of 2007 made things even more of a waiting game: how much bailout money would be spent? What sort of programs would the new administration be able to push through?

As I write this, the new stimulus package has been passed and is about to be signed into law. Its ultimate impact is unclear and there is much speculation as to how much it will help and when the effects will actually be felt. Consumers now know, however, that progress is being made and that certain benefits are coming their way.

To the boon of the automotive retailing industry, these benefits include an above-the-line deduction for the purchase of a new car. The deduction is limited – it is based on sales and excise taxes paid and the taxpayer's income, and applies to the first \$49,500 of the purchase price – however, it will be a selling point for some shoppers, especially in the last few months of the year, when the benefit of the tax savings is more imminent.

The same can be said for other provisions that are designed to put money into consumers' pockets – for example, a tax credit to be available on 2009 and 2010 returns may give a customer a little bit more to put toward their down payment. On the whole, however, we

may need to wait a little longer to see the benefit of these provisions as the affect of increased spending trickles through the rest of the economy.

Energy Prices Have Subsided

In addition, soaring gas prices have subsided to more reasonable, affordable levels. Sure, there is still room for volatility, and prices have started creeping up a little bit from the lows of November and December. The anxiety level caused by prices in excess of \$4 per gallon has subsided, though, and this means three things: consumers will start driving more, meaning more service visits; they will have a little more money in their pockets, meaning that they may be more likely to take care of some deferred maintenance on their vehicles; and finally, as the price at the pump slides from its place at the forefront of people's minds, it will be less of a deciding factor in their next vehicle purchase. While the prospect of prices permanently in excess of \$4 per gallon may have kept some consumers out of the market pending the next big advance in fuel-saving technology, the concern that a vehicle purchased today might be an albatross tomorrow doesn't have quite the teeth that it did a few months ago.

The Puget Sound Economy

I believe that the volatility in the stock market, and the financial crisis in general, has not necessarily had the impact on local spending power that one might be led to believe. The ups and mainly downs in the Dow and the fall of major financial institutions have made for dramatic headlines. Their impact has only been sensationalized by personal interest stories focusing on those who have taken direct hits – the family who has lost or is on the brink of losing their home, or the would-be retirees who are staying in the workforce having watched their retirement funds plunge in value.

These stories, combined with some well publicized hits to the Seattle-area economy – the prolonged Boeing strike and the failure of Washington Mutual last year, to name but two in a growing list – have left consumers more than a little dazed. I would argue, however, that the Puget Sound economy remains relatively stable compared to other parts of the nation. Our housing market has softened, but it is not nearly as bad as it has been in other parts of the country, and the impact of declines in residential construction has been softened somewhat by projects underway in the commercial sector. Remember, too, that our economy has grown somewhat and become more diversified over the past few decades. We are no longer so tied to a single industry that its ups and downs will necessarily have overwhelming reverberations throughout the rest of the economy. The "Boeing effect" may still exist, but it will not have nearly the consequences that it has in the past.

As far as the more blatant signs of the economic downturn go – lay-offs and downsizing – we have all certainly had our share, and more may well be on the way. As sobering as the past few months have been, however, they stand to work to your benefit. For all the pain your store may be going through, know that it has undoubtedly left your operations running leaner and meaner. This means that when things start turning around, your store will be positioned to reap the benefits all the sooner.

And yes, things will turn around. Customers are undoubtedly left either anxious or stunned when they turn on the news these days, but many still have the same purchasing power that they did last year and the year before. The volatility in the stock market may have put a significant dent in their retirement accounts, but for many, retirement is still years away, if not decades. Sure, they may be motivated to tuck away a little bit more of their paycheck in their savings accounts. But once consumers start to become a little more comfortable with their situations, demand will start to kick in again, and the money will be there to buy.

Credit is Available

Just as important, by all accounts, when your customers are ready to buy, the financing they want will be there too. GMAC's highly publicized tightening of credit standards in 2008 left many with the impression that even if they wanted a new car, they wouldn't qualify for a loan at all, let alone an affordable interest rate. The dealers I've spoken to tell me that, for the most part, this just isn't true. In their experience, financial institutions are limiting the extent to which they will lend relative to the MSRP or blue book, and they want the buyer to put a little more down. The days of the getting a customer into a different vehicle by financing a huge over allowance in their trade are pretty much over – and generally speaking this is probably a good thing. It can be read as a return to a normal, sustainable credit standard.

The bottom line here? An ongoing push to educate consumers about the availability of credit to clear up their misconceptions could go a long way toward getting them back in the showroom – and sooner than later.

An Up-Tick is around the Corner

Even with the doom and gloom that the media portends, we can all count on one thing: the recession won't last forever. Not only should those consumers who have the current capacity to buy return to the showroom soon, history has shown that as the U.S. economy starts to pull out of a recession, pent-up demand is released and vehicle sales spike.

When will this happen and how bad will things get before it does? The consensus for the industry seems to be that sales will slump further, and then start picking up again sometime later this year. Call me an optimist, but I believe that with the resolution of some of the uncertainty that has been weighing us down and the solid fundamentals of our local economy, stronger sales are just around the corner for our local dealers.

Circumstances are changing in favor of your customers, and sooner than later, they are going to realize it and start getting back into the game.