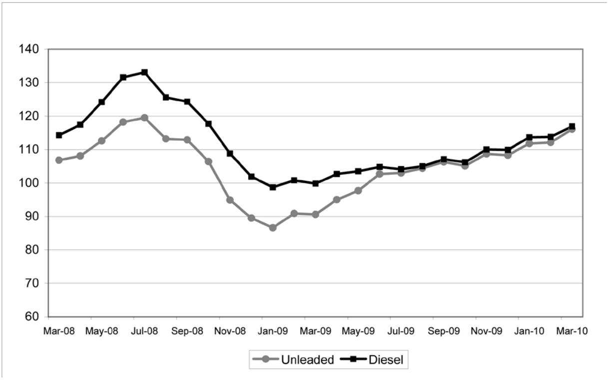
EDITORIAL COMMENT

Fuel costs to influence used car buying trends.

Of the total annual motoring costs incurred by motorists, depreciation accounts for around 45%. Whilst many would acknowledge this as a necessary evil of car ownership, some would be little surprised to learn that the second largest ownership cost is fuel at approximately 15%, higher than insurance, servicing, tyres, and taxes.

In recent weeks the price of a litre of petrol climbed to 119ppl. This is within spitting distance of the all time record of 120ppl reached in July 2008 (see chart recording prices up to March 2010).

UK Average Fuel price - Pence per Litre



Source: AA

In July 2008 the market was suffering low retail demand and very high trade supply, forcing prices into a rapid decent. However, the other negative influence on the market was the high price of fuel. In the July Editorial we referred to the "growing trade buyer sensitivity to large engined cars of virtually any description" and that all cars "over 2 litres are looked at with caution". Whilst accepting that diesel prices were still 13ppl higher than today, petrol prices are virtually matching this all time high reached in July 2008, and yet there is no visible backlash reflected in dealers' trade buying activities.

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The reasons for today's higher prices are varied. The increase in VAT on 1st January almost directly equated to an increase of 2.5ppl. There was a 17% surge in the in the wholesale price of petrol between February and March with a smaller follow through to pump prices, and this was followed by a 1ppl increase in fuel duty from 1st April. Throughout the period of the last 12 months the depressed state of the pound relative to the dollar (oil is priced in dollars on the world markets) has maintained the upward pressure on prices.

Given this series of increases and the fact that the press has not been backward in reporting these various events, it is surprising that there has not been any kind of backlash from retail customers this time around. In fact, those sectors of the used car market that could be described as fuel inefficient appear to be thriving. The most obvious example is the 4x4 sector that has recorded price resilience not seen in any other area of the market. Luxury, exotic, and super-sports cars are performing less well, but still better than the bread and butter market.

The absence of an adverse reaction to record matching petrol prices can be put down to a number of factors. Firstly, there is less of the 'feel bad' factor that pervaded the economy and the market in the summer of 2008. At the time there was the added buying disincentive in the shape of the large VED increases planned for the following April. Secondly, fuel prices have been increasing more slowly in recent months compared to the more dramatic increases seen just prior to July 2008. This suggests that the current high price of petrol may, so far, not have appeared on the radar of many motorists.

However, there is a good argument to say that used car buyers should give more consideration to fuel costs. This is because a used car purchase is an event that only takes place every three or more years. Therefore, it is not only important to consider fuel prices today but the extent to which prices may increase over this period of ownership. Of course, forecasting prices is notoriously difficult but we can single out those factors that will have a reasonable chance of coming to pass. For example, we know that the chancellor fully intends to add a penny to duty on 1st October, and a further 0.76p on 1st January 2011. We are also told that there is a commitment to the fuel duty escalator that will see pump prices rise by inflation plus 1p a litre each year between 2011 and 2014.

Then there are the factors that are more speculative but do have a reasonable chance of happening. We know that any new Government will need to raise taxation and the prospect of VAT increasing to 20% has already been mooted. This alone would add a further 2.5ppl to the price of fuel. Another suggestion is that a snap post election budget could include a duty hike of 2ppl. Neither is it likely that there will be much appreciation in the value of the pound versus the dollar for the rest of this year. This all comes before we mention the imponderable future increases in oil prices.

A reasonable conclusion is that fuel prices will significantly exceed inflation in the coming years, how much depends on speculation. We should also remember any reform of Vehicle Excise Duty (VED) will become more financially onerous on cars emitting high levels of CO_2 and, as we know, there is a direct relationship between CO_2 and fuel consumption. In other words, a used car that does not have very impressive fuel consumption figures is likely to face, not only higher fuel bills, but a bigger hike in VED. In addition all of us will be under more pressure to display our green credentials and improve our carbon footprints in the coming years. So if the financial pain was not enough, we could have to face a greater degree of social responsibility for our actions.

Even though we expect used car buyers to choose more fuel efficient cars in future we would not be predicting the demise of the large 4X4, luxury, and exotic sectors. Many decisions will be based on the premise that the car will not necessarily be the principal method of transport and could represent the second, or third car, in the family fleet. This means that the desire for ownership will remain high, but that the annual mileage will reduce.

Footnote

It is worth noting the convergence between petrol and diesel prices since this time last year (see chart). If the objective is to reduce fuel prices, now is a very good time to buy a diesel car (we shall cover this is more depth in next month's Editorial)

MARKET TREND

New car registrations

The SMMT reported registrations of 397,383 registrations for March, representing a year-on-year increase of 26.6%. Whilst the lion's share of this increase was from the private sector (up 53.5%) the fleet sector also made a very significant contribution (up 41.3%). The key point is that March represented the biggest selling month for 2 years and, therefore, there would inevitably be a knock-on effect to the used car market as we shall discuss later.

It was also interesting to note that 15% of the total monthly registrations took place on the last day of the month. This was heavily influenced by customers wanting to avoid the Showroom Tax (i.e. 1st year VED) due to take effect on 1st April. Thankfully, it had far less to do with manufacturer or dealer registration exercises. The feedback from dealers was that there was very little necessity to resume this practice because sales targets were being met from a natural market demand. Where the choice was made to register '10' plates it was often to create a nearly new car offering to customers in the absence of late used cars. So the decision was based on the dealers profit opportunity rather than the manufacturer's exerting their will to 'notch up' another registration

Used retail demand

The last two weeks in March continued the same positive trend established in the earlier part of the month with sales volumes and profit margins very much in line with the plan. April signalled a change in fortunes which coincided with the Easter weekend. Not only did this prove to be a little bit of a non event, and typical of previous years, but the following week became an extended holiday break for many and the purchase of a used car was not on many consumers' agendas. Thereafter, the market reaffirmed that March was, in fact, the peak selling month for 2010 as retail demand continued at this lower level. However, it was fair to say that, because many franchised dealers had made an assault on maximizing the new car sales opportunities in March, serving the needs of used car customers had been a secondary consideration until the early part of April. It is also worth noting that the March used car sales performances would have been bolstered slightly from retail interest deferred from the earlier bad weather.

Used car stock

The impact of the new registration month was immediate and significant. Even though dealers reported varying numbers of retailable part-exchanges some shortfalls were met. Additionally, dealer demonstrators entered used car stocks although some dealers had forward sold some of these units. It was the retail slowdown, and the anticipation that sales were likely to track at these levels, that led many dealers to believe that the balance of physical stock and anticipated demand was now out of kilter. However, stock shortages still existed, and this occurred because of a lack of late used supply with certain manufacturer's product. On a positive note, ageing used stock was not generally an immediate concern, but dealers were taking proactive steps to ensure that the problem did not arise.

Wholesale supply

The auction supply started increasing from a relatively low base during the second half of March mainly from unwanted dealer part exchanges. This is the start of a normal cycle of increased supply following the peak selling months of March and September. The difference this March is that the used car market has to suffer the 'fallout' from the biggest new car sales month for two years. These higher volumes reaching the auction halls continued unabated through the first 3 weeks in April. In addition, the recovery in new fleet business for March also had the effect of creating defleeted cars to swell the overall numbers. The expectation was that when fleet registrations started to recover it would be immediately followed with higher numbers of slightly older, and higher mileage, ex fleet cars that had been the subject of contract extensions. In the event, the additional numbers were modest, but at the time of writing there was still time for this situation to change. It is quite possible that the arrival of these cars will be typified by additional age (i.e. 4 to 5 months) rather than an appreciable increase in mileage. This will occur if fleets have been successful curtailing what they consider to be unnecessary business travel during the last 12 months.

Wholesale demand

Just as the supply increased the trade demand started to ease back. This was evident in the post Easter period. Encouragingly, attendance levels for physical and on-line sales continued to be quite high, and bidding was brisk, but on a narrower spectrum of used cars. As is always the case when the market starts to turn down it is the 'ready to retail stock' that remains more resilient to demand and prices. The 4x4 sector still defied gravity, but there were signs that the peak had been reached. Convertibles witnessed a much broader recovery encompassing all the brands.

By mid April conversion rates had fallen by between 3% and 5% compared to the previous month. Auctioneers were having to work had in order to extract bids, and dealer Disposal Managers were finding it more difficult to reconcile the high stand-in values – set 3 to 4 weeks earlier by the branches – with the best bids. It was the first suggestion that there had been some over trading by dealers eager to win business during March as they started to give too generously for part exchanges.

Late plate supply and demand

In many respects this area of the market continued to be more robust. This was a function of the limited supply from manufacturers and evidenced by the continued positive performances at closed sales. There was some limited availability from rental companies but the age and mileage parameters were a little excessive to make them prime retail stock. Provided there was no necessity to buy particular types and ranges of late used cars, the supply would not be described as short.

Prices

For our benchmark 3 year old cars from the volume segments, prices reached a peak towards the end of March and have made a gentle decent to the middle part of April. The degree of downward adjustment only amounted to 1%, yet there were a few manufacturers that were lifting prices slightly on certain model lines over this period.

Prospects

Dealers will be moderating their sales expectations over the coming weeks, not just because of the distraction caused by the General Election but because the second quarter is always considered to be more of a challenge. This means that trading buying activities will also be scaled back. At the same time the wholesale market will still be very busy processing the large numbers of unwanted cars from their vendors with increasing degrees of difficulty. Given this likely scenario, prices may well fall at an accelerated rate and this will be reflective of the more normal trading patterns we experienced prior to 2008.

Guide values

We have applied a slight reduction rarely exceeding 2%. There have also been increases applied to some late used models in limited supply, and more generally, to those cars coming into season.

There was an argument to apply greater reductions but the latest prices indicated more strength than the market sentiment.

Adrian Rushmore
Managing Editor

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