COVID-19 Market Update

5-27-2020

SUMMARY

In April we saw the largest monthly drop in wholesale prices since Black Book’s Retention Index was created in 2005 – adjusted for seasonality, the index dropped by 6.9% (this corresponds to a monthly 5.9% depreciation for 2-6-year-old vehicles). The decrease was driven mostly by the collapse of consumer confidence, along with high levels of uncertainty about the financial markets due to the COVID-19 pandemic. During the last three weeks, we have observed the stabilization of prices as ‘shelter in place’ orders are being relaxed across the country. As a result, auction sales volume is returning to pre-COVID-19 levels, although most auctions are still operating in a digital only environment.

After eight consecutive weeks of falling car prices, the trend reversed. This past week the volume-weighted car segment values experienced an overall gain of 0.12%, compared to a -0.16% decline the week before (-0.17% during the same week in 2019). Trucks and SUVs depreciated -0.23% during the past week, which is an improvement over the previous week’s -0.62% drop. Overall, we saw the market depreciate -0.11% vs. 0.46% the week before.

As we enter the summer months, we expect both wholesale and retail prices to deteriorate even further. We attribute this projected decrease to the large influx of incremental used inventory expected to hit the marketplace, the weakening of retail demand due to the deep recession, and corresponding unemployment numbers.

Since the beginning of April, unemployment claims have continued to increase. Last week, the Labor Department reported that the US added 2.44 million new jobless claims¹, bringing the total claims to over...
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38.6 million since the start of pandemic. The US unemployment rate in April was 14.7%, the highest monthly rate since the Great Depression. With a weakening of the economy, consumer confidence is decreasing. The University of Michigan's monthly consumer sentiment index\(^2\) was 71.8 points in April, and is expected to increase slightly to 73.7 points in May, mostly due to the arrival of stimulus checks. As a comparison, the index was at 101 in February. A recent report on the Economic Well-Being of U.S. Households by The Federal Reserve\(^3\) estimated that “thirty-nine percent of people working in February with a household income below $40,000 reported a job loss in March.” At least 20% of all new car buyers fall into this category. Additionally, “the GDPNow\(^4\) model [from the Federal Reserve] estimate for real GDP growth (seasonally adjusted annual rate) in the second quarter of 2020 is -41.9% on May 19th.” As a result, the weakening of the economy is causing demand on vehicle purchases to decline.

At the same time, we expect a large incremental influx of used inventory to hit the marketplace over the next 6 months coming from delayed lease returns, downsizing of rental fleets (including the expected sell-off of a large number of Hertz’s units), increased repossessions, and un-sold inventory from the March-May time period. In accordance, we are projecting a steep decline in wholesale prices over the next several months, with some leveling off by the winter.

Although the economic effects of the pandemic will continue to be felt as far out as three years from now, we project that wholesale values will return to the pre-COVID-19 baseline by 2023, as used supply will decline due to cuts in retail and fleet sales throughout 2020 and into 2021.

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1. https://fred.stlouisfed.org/series/ICSA
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CURRENT WHOLESALE MARKET OVERVIEW

Black Book’s Automotive Analysts have a combined 200+ years of insight and experience in the automotive industry. Through ongoing communication with dealers, remarketers, and auctioneers, our analysts track vehicles in order to independently chart and report the market via daily updates. In addition, our survey personnel attend (virtually at the present time) over 60 auctions every week.

Auction Insights

Auctions continue to show signs of returning to “normal” as prices have stabilized, bidding and buying activity has increased, and auction personnel are returning to “catch-up” with the backlog of vehicles waiting to get a condition report and reconditioning performed.

Independents that have resumed their physical sales are reporting the strongest sales prices and volume. In some cases, the supply is down at these auctions due to 2 weeks of high sales conversions, which have left them without a large supply of inventory as they await repossessions to resume.

The largest auctions, Manheim and ADESA, continue to operate all locations under digital only sales platforms.

Auction Volume

We continue to see a rebound in volume in the wholesale marketplace. It appears that we have some stability now, as throughput of wholesale auctions is limited by closure of most physical auctions and reduction of staff by major auction companies. Last week, sales resumed to near prior year levels and, in some cases, slightly above prior year. Sales volume bottomed out around an 80% year-over-year decline when most auctions closed their physical sales (and some closed entirely) at the end of March. The graph below illustrates the estimated year-over-year change in sales volume of the wholesale market.
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Sales Rate

Sales rates quickly tumbled into the teens when the pandemic initially forced people to shelter in place, but rates have been slowly climbing each week. Last week, we observed sales rates continuing to climb as the ability to preview inventory, and in some cases be physically present in the lane, gave dealers more confidence in their purchase. Black Book’s estimate of the Weekly Average Sales rate is presented below. We continue a steady march towards historically “normal” sale rates.

![Weekly Average Sales Rate at US Auctions]

CURRENT WHOLESALE PRICE TRENDS

Market Level View

Volume-weighted, overall car segment values increased by 0.12% this past week. The majority of vehicle segments experienced increases or stability, except for Near Luxury Car and Prestige Luxury Car segments. Near Luxury Car is a segment with a high lease penetration rate, and we project that depreciation is likely to worsen as consumers who took advantage of lease extensions begin to return their vehicles. Due to the high MSRP's of the Prestige Luxury Car segment, it is typical to see them depreciating during this time of year.

Compact Cars continued to trend upward for a second week in a row, with a 0.72% increase. This segment was hit hardest at the onset of the pandemic as fuel prices were falling quickly, but this segment has now seen an increase in demand due to its low price point. When volume-weighting is applied, the overall Truck segment (including pickups, SUVs, and vans) values decreased by -0.23% last week. Small Pickups increased for the second week in a row. The Minivan segment saw large declines for another week as large supplies on the
lanes have continued to depress prices in a segment that has a niche demand.

The graph below shows week-over-week depreciation rates for the entire market, including Cars and Trucks / SUVs / Vans for the last several months. During the last three weeks we have observed that weekly depreciation rates have started to slow down and, in the case of cars, increased in value this past week.
Segment Highlight – Mid-Size Crossover/SUVs

Ousted by Full-Sized Pickup Trucks and Full-Sized Crossovers/SUVs, the Mid-Sized Crossovers/SUV (MSU) segment accounts for the third largest sized truck segment in the US. For families and outdoor enthusiasts requiring a little more ground clearance than their station wagons provided, or more seating than their pickup trucks can offer, MSUs fulfill a gap that many Americans find necessary for everyday life. Today, the MSU segment accounts for roughly 14% of the vehicles on the road, a number that has slowly increased since the 1980’s. Going forward, we see this segment continuing to grow as OEMs offer both new and historic nameplates to help increase their market share. As the popularity for this segment increases, it is now even necessary to split it into two different sub-segments, which include 2-row and 3-row MSU. Here, we have very similar sized vehicles, often within the same make, competing in the same segment, but offering consumers more specialized solutions to their everyday problems.

SUVs have become wildly popular over the standard sedan and are currently offered in almost every size imaginable. In 2006, Ford introduced the Edge, a 2-row MSU that offered consumers both the size and seating configuration they desired. We now have various OEMs producing different models that compete in the same class of vehicle. These include Traverse and Blazer, Pilot and Passport, Atlas and Atlas Cross Sport, just to name a few. Jeep Grand Cherokee takes the number one slot in new vehicle sales, while the Toyota 4Runner and Highlander retain their values the best. On the Luxury side, the Lexus RX 350 has the highest sales numbers, while the Lexus GX 460 has the best retention in that segment. As this segment evolves and adapts to consumer demand, we see it continue to pull market share away from car segments, as well as other SUV segments. With constant new introductions like the Kia Telluride, Hyundai Palisade, and Audi Q8, OEMs have
some stiff competition to market against in this very crowded segment.

At the beginning of the shelter-in-place orders, wholesale values for Mid-Size Crossovers began to fall, but at a slower rate than some of the other crossover segments. The rapidly falling fuel prices helped support this segment, while hurting the smaller, fuel-efficient crossovers and cars. Like the majority of the other crossover/SUV segments, MSUs continues to depreciate each week, but the rate of depreciation has slowed.

Used Wholesale Price Projections

Wholesale Price Impact Under the Most-Likely Economic Scenario

Wholesale prices dropped significantly in April as uncertainty over COVID-19 impact and response dampened vehicle demand, resulting in an overall wholesale price decline of 5.9% in April alone. Typically, used prices increase during the spring market, and as a result, April actual wholesale prices were 13% below projected values, as illustrated by the graph below. Projections are indexed to the pre-COVID-19 projections (black line).
Black Book’s published May Residual Values (dashed lines) reflect a new economic reality – projected values will continue to stay well below pre-COVID-19 projections over the next two years. The green line represents our most-likely economic scenario. A more severe recessionary scenario is shown in red.

**Short-Term Outlook (Summer/Fall of 2020)**

We project a drop in wholesale prices compared to a pre-COVID-19 baseline this summer/fall as the US economy suffers through the effects of COVID-19. We anticipate that wholesale prices will be 17% lower, on average, compared to pre-COVID-19 projections, during the remaining months of 2020: larger difference over the summer with some recovery early in 2021. We also anticipate that older (>6-year-old), cheaper vehicles in average condition will not decline as much due to increased demand for these units.

**Long-Term Projections (36-Month Residual Values, Summer/Fall of 2023)**

The effects of the pandemic will continue to be felt, but we project that values will return to the pre-COVID-19 baseline as used supply will decline as a result of cuts in retail and fleet sales throughout the remainder of 2020 and into 2021.

**Wholesale Price Impact Under a Severe Recession Scenario**

In this scenario, we project a 24% drop in wholesale prices compared to a pre-COVID-19 baseline this summer/fall, with a very slow recovery in 2021. The effects of the pandemic and recession will still be impactful in 36 months, and we project a 10% market level decline of wholesale prices as compared to pre-COVID-19 projections for the second half of 2023.

**Segment Highlight – Mid-Size Crossover/SUVs**

During the last recession, SUV segments experienced a larger decline compared to sedans. This time around we we project the drop to be similar in magnitude due to low gas prices and continuous production cuts in cars segments over the last several years. SUV segments depreciated at a slower rate compared to cars in April (-5.2% vs. -7.0% respectively), but will have a higher depreciation rate over the next several months. The graph below shows the expected change in retention value compared to the pre-COVID-19 outlook. Projections are indexed to the pre-COVID-19 projections (black line).
RETAIL VERTICAL

Retail Prices

We continue to see decreases in retail asking prices as consumer confidence took a dip in April. Currently, retail prices are decreasing at a much lower rate compared to wholesale prices – we saw a decrease of about 5% from the peak in early April compared to last week. We expect retail prices to decline further, at a higher rate, as consumer demand weakens over the next several months, hence narrowing the gap between wholesale and retail prices.
Dealer Insights

- Memorial Day weekend has historically been a big weekend for car sales, and the dealers we spoke with were hoping this year would be no different. We expect to see continued buying on the lanes post-Memorial Day to backfill sold retail units.
- Dealers are continuing to remain “cautiously optimistic” that the price stability and uptick in retail sales will last.
- Hesitancy remains when it comes to sending trade-ins or unwanted inventory to the auction for disposal, but with low wholesale values, the auction has become a good source of inventory.
- After two months without production lines running, concern continues to build for new car dealers about the level of inventory and how long it will be before they receive new units from manufacturers.

NEW VEHICLES SALES OUTLOOK

Our New Sales Outlook remains unchanged from last week. We anticipate a significant reduction in US new vehicle sales in 2020 (both retail and fleet sales) due to continued reduced consumer demand. This is resulting from several ongoing factors, including less miles driven due to remote work and shelter-in-place initiatives, high unemployment, and an overall feeling of uncertainty by consumers. New sales were down 21% during the first 4 months of the year compared to last year (with a 47% YOY drop in April as most states were under ‘shelter in place’ orders).

In our base economic scenario, we project a 25% drop (compared to pre-COVID-19 projections) in new sales in 2020, to 12.7mm units. In a deep economic recession scenario, we project a 40% drop in new sales in 2020 to 10.2mm units.

3https://fred.stlouisfed.org/series/TOTALNSA
In the longer-term, we expect new sales volume to return to pre-COVID-19 levels within 5 years. The table below summarizes Black Book’s projections for new vehicle sales for the next several years under both economic scenarios.

<table>
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</table>

**USED VEHICLE SUPPLY PROJECTIONS**

Black Book projects a higher than expected used vehicle supply in the wholesale marketplace for the rest of 2020 due to several factors:

- Delayed lease returns resulting from lease extensions offered by OEMs
- Extensive de-fleeting by rental car companies due to lack of consumer demand
- Dramatic reduction in auction activities due to COVID-19 in March, April, and May
- Increased repossessions due to deteriorating economic conditions

**Short Term Lease Return Projections**

When we started this year, lease returns were projected to hit a record volume of above 4.1 million units. Once the pandemic was underway and most manufacturing stopped, OEMs started to encourage lease extensions in order to push returns further into 2020 and to be able to provide replacement vehicles. As a result, we project at least 560,000 additional units in the second part of 2020 (compared to the pre-COVID-19 estimates) due to a slowdown in sales in April / May, along with expected turn-ins of the lease extensions.
Rental Unit Returns

Business and leisure travel collapsed at the end of March. We expect a significant reduction in both categories for the remainder of 2020. In addition, there is no expectation that travel will return to pre-COVID-19 levels in the next several years. According to IATA (The International Air Transport Association), air travel will not return to pre-COVID-19 levels until after 2023\(^6\). This puts tremendous financial pressure on rental companies that rely on air travel to reduce both their current fleet and future acquisitions. Last week, Hertz filed for bankruptcy\(^7\) in North America as a result of the pandemic.

In addition to Hertz, we expect other rental companies to reduce their fleet during the summer and fall months to match lower demand for rentals. This practice will lead to over 250,000 additional rental units hitting the wholesale market over the next 6 months. Note that this is a base case scenario in which rental companies (excluding Hertz) can gradually reduce their fleet instead of rapid fire-sale.

The graph below shows Black Book’s projections for rental returns. The purple line shows the difference between current (darker rectangles) and pre-COVID-19 projections (lighter rectangles).

In the longer term (later 2021 -2023), the drop in rental return volume will benefit the price of newer used units, as supply will be limited.

\(^7\)https://www.autonews.com/used-cars/hertz-files-bankruptcy-after-rental-car-demand-vanishes
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Longer Term Used Returns Projections

With the reduction in retail and fleet sales over the next several years, we project approximately 75k used units per month less in the market in 3 years, compared to previously projected returns. This lower level of used inventory will be beneficial to used car prices as supply will be limited.
About Black Book

Black Book® is best known in the automotive industry for providing timely, independent and precise vehicle pricing information, and is available to industry-qualified users through online subscription products, mobile applications and licensing agreements. Since 1955 Black Book has continuously evolved to ensure that it achieves its goal of delivering mission-critical information to its customers, along with the insight necessary to successfully buy, sell, and lend. Black Book data is published daily by National Auto Research, a Hearst company, and maintains offices in Georgia as well as the Canadian Black Book in Toronto.

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