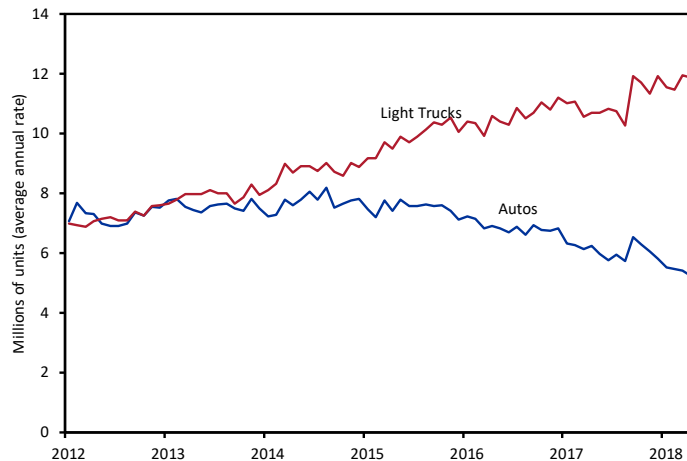


NATIONAL ECONOMY

The announcement by the Ford Motor Company that it will basically stop producing cars for the North American market accentuates the trend from cars to CRVs and SUVs and light trucks that has been building for years (see figure below). In addition to the conversion at Ford's Michigan Assembly Plant in Wayne, Michigan, General Motors will suspend the second shift at its Lordstown, Ohio, plant, where it makes the Cruze, a small sedan. The GM decision alone will idle 1,500 workers. Most likely, the Michigan Assembly Plant and the Lordstown plant are only the first among many that will soon be either converted to trucks or shuttered.

U.S. Auto and Light Truck Sales, 2012–2018

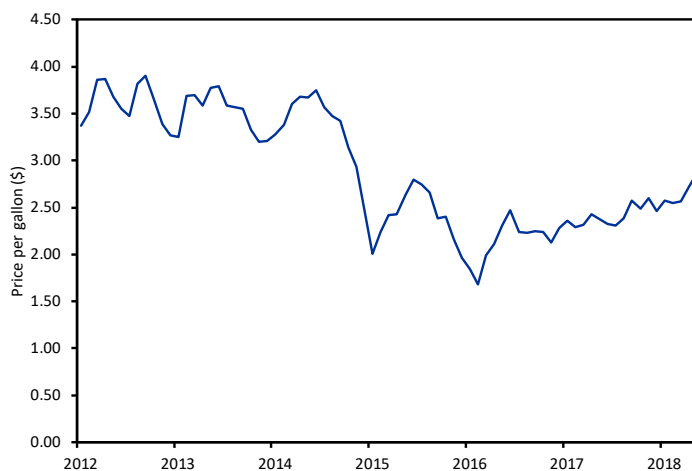


The last time autos outsold light trucks was in early 2013. Since then, the gap has widened until light trucks now account for fully two-thirds of the market.

SOURCE: Bureau of Economic Analysis.

It hasn't been that long ago that high oil prices pushed gasoline above \$3 a gallon and truck sales tanked. In May 2006, the *New York Times* ran an article titled "High Oil Prices Hurt U.S. Sales of SUVs" (May 3, 2006), in which it reported that SUVs and pickup trucks were among the vehicles that had the sharpest sales drops, with the Ford Explorer down 42 percent compared with April 2005 and the Jeep Grand Cherokee having declined 41 percent. The article quoted several analysts, including Ford's chief sales analyst, as remarking that many of the SUVs were planned for an era of \$1.50 a gallon gasoline. It is difficult now to imagine a world with gas prices that low; the last time was in December 2003, and prices have never been that low since.

Retail Gasoline Prices (all formulations, all grades, Midwest)



Gas prices have been climbing again in 2018, approaching the threshold of \$3 a gallon. Auto manufacturers are betting this won't dissuade consumers from choosing light trucks over cars.

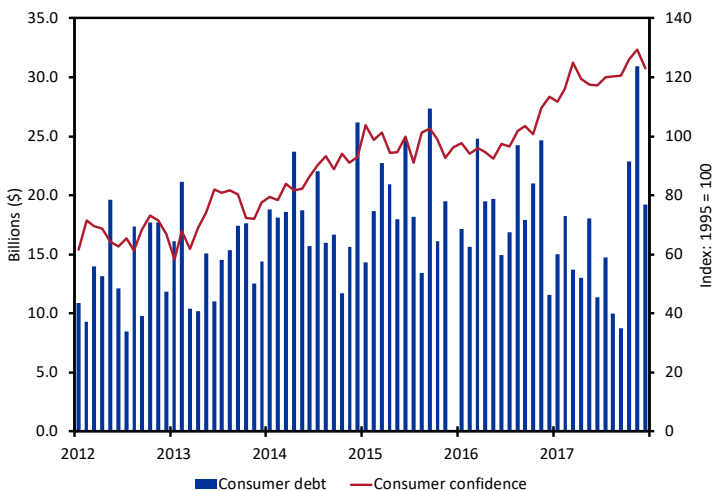
SOURCE: U.S. Energy Information Systems.

So, what makes Ford and other automakers so sanguine about light trucks, when gas prices are once again in the \$3-a-gallon range (bottom figure, previous page), with prospects of going higher? One reason is an increase in fuel efficiency. For example, the fuel efficiency of the 2018 Ford Explorer, a standard all-wheel-drive SUV, has increased 25 percent over its comparable model in 2005, from 20 miles per gallon to 25 miles per gallon (highway). Even the standard pickup truck now has higher gas mileage. The Ford F-150, for example, gets 24 miles per gallon today compared to 20 miles per gallon in 2005 (EPA, Fuel Efficiency Guide). Yet, even with the greater fuel efficiency, drivers of the F-150 are paying 13 percent more at the pump to operate them than they did in 2005.

Although these changes in fuel efficiency may not seem that dramatic, consumers seem to respond positively to even relatively small increases. A recent study showed that sales of SUVs, CRVs, and light trucks that increased gas mileage by 10 percent or more between 2011 and 2016 rose 59 percent, compared to sales increases of only 41 percent for these types of vehicles with fuel efficiency increases of less than 10 percent. The study cites the Toyota RAV4, which increased its fuel efficiency by 10 miles per gallon and saw a sales increase of 166 percent. An update to the study concludes that the most popular vehicles have significantly increased their fuel efficiency, which would not have happened without current fuel efficiency requirements.

The success of this strategy for the U.S. economy depends upon stable gas prices and stable trade relations. Gas prices have risen 30 percent since last year at this time and are now flirting with \$3 per gallon. A decision by

Consumer Confidence and Change in Consumer Debt



Personal consumption continues to drive the U.S. economy and looks to continue to grow, as consumer confidence recently reached its highest level yet, approaching a mark of 130. The forecast for 2018, compiled by the Federal Reserve Bank of Philadelphia from the Survey of Professional Forecasters, suggests that growth will remain at about 2.5 percent through the end of the year—still well above the 10-year moving average.

the Organization of Petroleum Exporting Countries (OPEC) to limit production has increased prices, and political uncertainty among nations has conspired to raise the price of crude oil from just under \$50 a barrel in the first quarter of 2017 to the mid-\$60 range. The increased fuel costs, if the mid-2000s are any indication—particularly if they are abrupt—could put a damper on the auto industry as it pursues its new strategy.

A possible trade war could also affect vehicle sales. The administration has threatened to slap tariffs on many imports as a means to create better bilateral trade agreements. The administration argues that our current trade deals are unfair, as trading partners already impose tariffs, demand local content and final assembly, and limit access to markets.

Negotiations to update the North American Free Trade Agreement (NAFTA) continue. If these negotiations break down, relations with major trading partners Canada and Mexico would suffer, and our neighbors could impose tariffs in retaliation for ending NAFTA. This could cost jobs in export industries, as American goods would be priced higher, and it could also reduce consumption, as the cost of imports would rise. While the Ford F-150 is made exclusively in the United States, many Chevy trucks are made in Mexico.

Much of the recent investment in the auto sector in Mexico, according to the Center for Automotive Research in Ann Arbor, stems from trade agreements with Mexico through NAFTA that allow the country to export vehicles to the United States. Without the NAFTA provisions, Mexico could experience higher supply-chain costs and so might decide to move production offshore to countries with lower costs.