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Despite Higher Auto Sales, Economists Expect Incentives to Slow

NEW YORK, May 2 (LendingIntelligence.com) — Though incentives have played a major role in the unexpected surge in light vehicle sales this year — all major automakers, except Ford Motor Co., reported gains today — industry analysts expect manufacturers to soon start slashing some programs.

Sales of cars and light trucks in the U.S. overall rose 2.9% in April from a year earlier, according to Ward's AutoInfoBank, an industry database.

General Motors Corp. led the way posting a 12.4% increase in sales for April, while Chrysler Corp., a unit of DaimlerChrysler AG, reported a 3% gain, and Ford slid 7.4%. Meanwhile, Nissan Motor Co.'s U.S. sales jumped 15%, while Toyota Motor Corp. (0.3%) and American Honda Motor Corp. (1.1%) reported more modest sales increases.

"Sales started out strong from the beginning of April, due in large part to the incentives programs from the Big Three, pushing the market much higher than most analysts anticipated," said Robert H. Schnorbus, chief economist at J.D. Power & Associates, Agoura Hills, Calif.

Already, though, there are signs the automakers are reworking their incentive strategies. General Motors, which launched the wildly popular 0% financing program that swept the industry following Sept.11, announced yesterday it would end 0% financing, lower discounts on certain popular sport-utility vehicles, and raise them on less successful models.

"Going forward, I definitely see a pullback on certain incentives programs, as we are seeing now with GM," said Greg Jelinek, executive vice president of the dealer finance division at National City Bank. "The fact is that they just can't afford to offer some of these programs forever. The incentives have been, in some cases, at historical levels. Now that GM has cancelled 0% financing, I expect the others to soon follow."

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Schnorbus agreed.

"I think they're already starting to juggle and shuffle their incentive programs, but I still expect them to remain relatively high," he said. "They need to maintain these sales levels, or close to it, to keep their factories operating at full capacity. If they don't keep pace in the incentives battle, they run the risk of losing marketshare, which will come back to haunt them."

Many analysts tie incentives directly to the higher sales levels.

"If the incentives were to disappear tomorrow, the sales rate would be at least a million units slower," said David L. Littmann, chief economist at Comerica Bank. "Incentives are playing an essential part in auto sales, and it is incumbent on the automakers to realize profits through these cost-cutting measures."

Regardless of the popularity of 0% financing, with interest rates creeping higher, the programs are becoming prohibitive and yielding to other incentive programs.

"We're going to see more cash-back incentive programs," said Schnorbus. "We'll still have to wait and see ultimately what manufactures do with interest rate tools, and it looks like they'll be moving away from them. Already, GM is blending the two with a net reduction in interest rate programs in favor of cash rebates."

GM's new "1-2-3" program offers 1.9%, 2.9% and 3.9% financing, as well as $1,000, $2,000 and $3,000 cash discounts.

Moving forward, analysts expect auto sales this year to hit the 16.5 million-unit mark — slower than the 17.4 million-unit rate the industry saw last month.

"Sales will slow from April's pace," said J.D. Power's Schnorbus. "It won't be a big collapse, but just a pullback to about the average we saw in first quarter, which would put annual sales at 16.5 million."

Bankers like Jelinek are waiting to see how things shape up.

"We're holding our breath," he said. "While we're on target with our retail loan volumes, I was surprised GM's and Chrysler's numbers were so high, because we're hearing from our dealer base that traffic is lighter."

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