



Auto sector feels pinch of credit crunch

Loan delinquencies could have an impact on whole economy

By Roland Jones

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Driving a sporty car was nice, but with high gas prices and inflation pinching at his pocketbook, Jorge Valdes decided last October to get rid of his white BMW 525i sedan when the \$700-a-month lease payments became too much to bear.

Valdes turned to LeaseTrader.com, an online service that allows one car-lease owner to transfer it to another before it expires. He passed on the remaining 16 months of his 36-month lease to another driver, allowing him to lease a new, cheaper car and lower his monthly car payments.

"With gas and insurance I was paying over \$1,000 a month to drive a vehicle and it didn't make any sense," said the 27-year-old firefighter who lives in Miami.

"The economy was one of my main reasons for getting rid of the lease," he continued. "Gas prices are going through the roof and the economy isn't getting any better; everyone hopes it will, but I don't see it getting any better any time soon. There's nothing out there that's going to pick us up."

Just as delinquencies and defaults are rising in the housing sector, problems also are mounting for auto lenders as consumers like Valdes look to get out of their costly car leases or struggle to make their car-loan payments.

Rising inflation, high gas prices and a tightening home mortgage market have driven up auto-loan delinquencies, according to Fitch Ratings, the credit-rating agency. The number of Americans who are more than 60 days late on their car-loan payments rose to a 10-year high in January, Fitch recently reported, attributing the rise in late payments to "increasing pressure on the consumer" in a weakening economy.

The problem is so acute it could weigh on the overall U.S. economy, according to Lawrence B. Lindsey, former director of the National Economic Council and now CEO of the Lindsey Group, an economic advisory company in Washington. He told CNBC last week that "the next shoe to drop" in the credit crunch could be the auto-loan sector.

"We're talking about a half-trillion-dollar industry, and if you take away a quarter of it that's one point of [gross domestic product]," he said. "Washington is focused on the [tax rebate] checks they're about to send out, and that's great because a \$1,200 check is a down payment on a car, but if you can't borrow the other \$25,000 to buy the car then you can't buy it, period — that's why the credit channel is the most important thing to focus on."

On Tuesday, automakers reported double-digit U.S. sales declines for March as demand for trucks and sport utility vehicles plummeted and consumers refrained from buying new cars. General Motors said its U.S. sales fell 19 percent, while Ford's sales dropped 14 percent. Jim Farley, Ford's sales and marketing chief, said in a conference call with reporters and analysts that the company is concerned the shrinking availability of consumer credit will continue to hurt sales and that the second quarter could be more difficult than the first.

Carol Kaplan, spokeswoman for the American Bankers Association, a trade group for the banking industry, notes that auto loans make up half of all U.S. consumer loans, excluding mortgages.

"This certainly tells us what's going on in the economy," Kaplan said. "We can say without question that auto loan delinquencies are rising and that we expect them to continue to rise."

She added that delinquencies for other consumer loans tracked by the trade group, including credit cards, home equity loans and lines of credit and bank cards, also are rising.

The rise in delinquencies comes at a time when more Americans are stretching to buy cars, opting to purchase longer loans to be able to make their monthly payments and also afford other everyday expenditures, such as mortgage payments and credit card bills.

A typical car loan lasts five years, but many are now stretching to six — and even seven — years, according to data from the Power Information Network, a division of market research company J.D. Power and Associates. In January, Toyota started offering the previously rare seven-year loans to customers.

Longer auto loans are a dangerous road for car buyers, who can end up “upside-down” on a loan, meaning they owe more money than the vehicle would be worth if they sold it. For example, the average lease on a \$20,000 car with a 7 percent interest rate for seven years can saddle the lessee with an additional \$5,335 in interest alone — roughly one quarter of the car’s entire price, according to LeaseTrader.com.

For U.S. automakers, longer loans could mean added pressure as they work to turn around their North American operations. If more car buyers are locked into longer car leases and loans, they’re unlikely to buy new cars as often. U.S. auto sales are already expected to be weak this year because of the harsh economic climate and a dearth of appealing new models on offer.

After slow performance in January and February, J.D. Power and Associates now expects new vehicle sales for 2008 to reach their lowest levels since 1995, dropping to 14.95 million cars and light trucks. J.D. Power previously forecast new-vehicle sales for 2008 to be 15.7 million vehicles. Annual sales of about 16 million are generally seen as healthy.

“Declining consumer confidence and spending, as well as turbulent financial and economic market conditions, are primarily driving the decline,” said Jeff Schuster, executive director of automotive forecasting for J.D. Power.

The big U.S. automakers are relatively sanguine about the outlook for sales, and they say they’re not seeing a dramatic increase in loan delinquencies.

General Motors Vice Chairman Bob Lutz said recently that the automaker still expects sales to head higher in the second half of 2008, but may revisit that assessment. Top executives at Chrysler, the U.S. automaker acquired for \$7.4 billion last year by private equity firm Cerberus Capital Management, have said publicly they are not planning on seeing sales rebound in the second half of the year.

With consumers’ concerns about high gas prices, the housing slump and tightening credit unlikely to abate, John Sternal, head of marketing at LeaseTrader.com, expects business to pick up this year as more drivers like Jorge Valdes opt to downsize their auto leases before they run out. He expects his site to see 45,000 lease transactions this year, up from 35,000 in 2007.

“Your car payment is typically your second biggest monthly payment, and over the last six months we’ve seen a 25 percent increase in customers looking to downsize to a smaller vehicle, or something more fuel-efficient,” Sternal said. “For us, that’s significant because we normally only see a 2 percent shift here or there, and it definitely correlates with what’s going on in the economy.”

The Associated Press contributed to this report.

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