The Oil Drum: Europe
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

UK new car sales and the recession

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Topic: Economics/Finance
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I just finished reading a book called **Anatomy of the Bear** where the point was made that rising new car sales are a leading indicator for the end of recession. No wonder then that many OECD governments introduced incentive schemes to boost new car sales following the dive off the cliff that accompanied the credit crunch (Figure 1). Cash for clunkers in the USA was called the Scrappage Scheme in the UK. No prizes for spotting when the credit crunch recession began in the UK. But what will happen now that the scheme is due to end shortly?

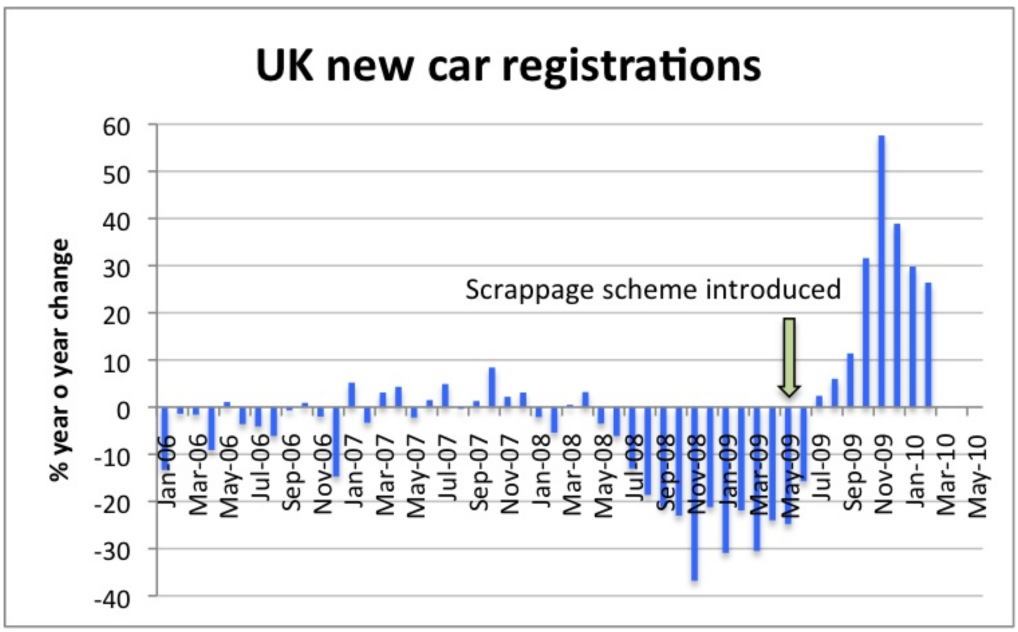

Figure 1 *Year on year change in monthly new car sales. Source is **The Society of Motor Manufacturers and Traders**. The decline in new car sales accelerates from July 2008 with 20 - 30% year on year declines. The Scrappage scheme, introduced in May 2009, helped pull car sales around, but by December 2009 it seemed to be running out of steam and will end in March 2010.*

So why are new car sales of interest to The Oil Drum? Transportation is of course one of the main consumers of petroleum. But since the oil price spike of 2008, I think many have become aware of the links between economic growth, energy consumption, energy prices and how this impacts forward production capacity. It's a much more complex web than I ever imagined. New car sales are but one economic indicator of things to come.

The UK car scrappage scheme

The UK car scrappage scheme was introduced in May 2009 to rescue the auto industry from car sales that were plummeting in response to high energy prices and the credit crunch. Cars that were 10 years old or older, most of which would have no intrinsic value, could be traded in for £2000 part exchange for a **new car**. The government provided £1000 of this subsidy and the motor manufacturer the rest.

As figure 1 shows, this £2000 subsidy did the trick and car sales began to recover immediately. I personally took advantage of the scheme in December and discovered that the incentives on offer went way beyond the £2000 scrapage. As described below, Volvo made me an offer I couldn't refuse.

The government initially allocated £300 million to the scheme (300,000 cars) but in September 2009 the scheme was extended by £100 million which meant that it carried on into 2010. It should have ended at the end of February but has been extended again to the end of March and is therefore still active. I'm expecting car sales to decline once the scheme ends but April's statistics will come too late to influence the outcome of our General Election that will be held in early May. It is hard to not suspect some cynical electoral manipulation at work here.

The UK car market

Pre-recession, the UK car market was running at approximately 2.4 million units per year. Monthly sales are highly distorted by a quirk of UK license plate system where the first two numbers of the plate indicate the date of manufacture. This used to reflect an annual period, and motorists would wait to buy a car when the new annual plate was issued. Since this distorted the market, this was changed to a 6 monthly date mark, but the market is still hugely distorted. In March and September when the new license plates are issued sales are more than double the monthly means. In the preceding months, February and August, sales are less than half the monthly means, as motorists delay purchases in order to get the new license plate.

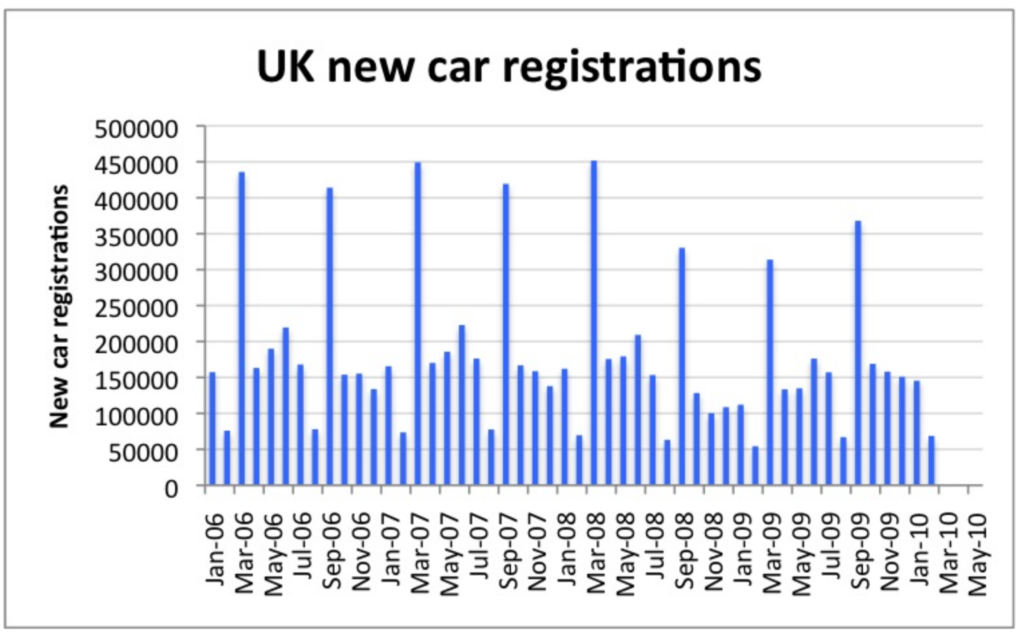

Figure 2 *UK new car sales are heavily distorted by new license plates issued in March and September of each year. The September 2009 peak is pulled up by the scrappage scheme but is still well below pre-recession levels.*

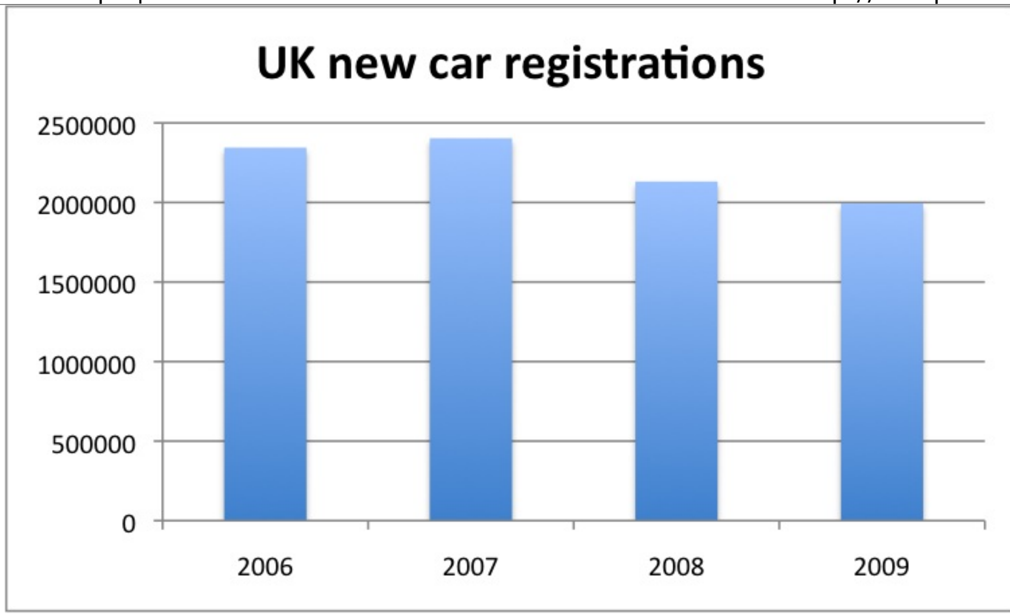

Figure 3 *The recession began mid-2008, hence the 2008 figures are affected by only 6 months poor trading. The Scrappage Scheme introduced in mid-2009 has inflated the 2009 figures which are still below 2008. 2010 figures will benefit from 3 months of Scrappage and then we will see how robust UK economic recovery really is.*

The other notable seasonal effect is that June is always the peak sales month outside of the March and September peaks.

Given the highly variable monthly sales figures, it is tricky to discern trends from the raw data, though the March and September peaks are clearly down in 2008 / 9 as a result of the recession. Hence, it is easier to view trends from the year on year (YOY) changes to monthly sales (Figure 1) but even these need to be viewed with caution since the spectacular rebound from July 2009 needs to be viewed against the very depressed sales figures from the previous year. Since July 2009, car sales are still running well below levels of two years ago.

As of 28 September 2009, **227,750 motorists** had taken advantage of the scheme.

In the period June to September 2009, 768,348 new cars were registered, thus the scrappage scheme accounted for 30% of new car sales in this period. Of course we do not know how many scrappage buyers may have bought in any case, but as described in the box below my own decision to buy a new car was totally swayed by the discounts that were on offer.

In 1995, whilst I was still running a small business, I bought a new Volvo 850, 2.5 L estate car. My children then were 5 and 3 years old, and this car was to become a much loved family work horse. 15 years later, and with 140,000 miles on the clock, this old car still had much life left, but year on year was costing an awful lot to keep on the road. With the scrappage scheme knawing away at the back of my mind, I ventured up to the Volvo dealer mid December 2009, thinking about buying a second hand replacement. And there in the middle of the showroom was a spanking new Volvo V50.

I told the salesman I was wanting to buy a used car. He told me that in addition to the £2000 scrappage, Volvo were offering additional discounts to existing Volvo owners. At this time UK VAT (sales tax) was reduced form 17.5 to 15% and all in I was offered £5,500 discounts on the new V50 in front of me. Not only that, this 1.6 diesel model did over 60 miles per gallon and because it was so green :-) the annual road tax would only be £35 (compared with our other car that costs £220 to road tax per year). I thought about all of this for about 3 seconds, and told the salesman that the breadwinner would have to approve. We concluded the deal the same day. Without all these incentives I would have bought a used car.

Where next?

On the back of £200 billion in quantitative easing (QE), the car scrappage scheme, a cut in value added tax (VAT) from 17.5 to 15%, reduction in tax on property transactions and running up mind boggling debt, the UK managed to squeeze out 0.3% growth in the 4/4 of 2009. QE has been suspended though looks likely to return, the VAT reduction has now been reversed and car scrappage is in its final month.

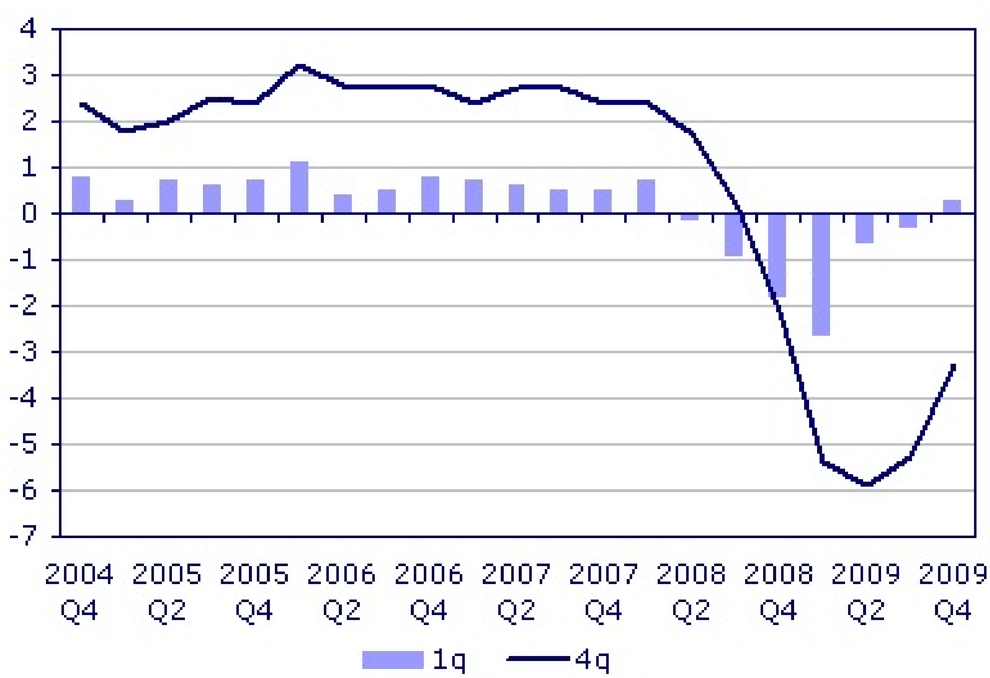

Figure 4 *UK GDP quarterly figures and 4/4 running mean from* ***UK government statistics***.

The impact of car scrappage looks like it peaked in the 4/4 of 2009 (Figure 1). Most of those who owned a 10 year old car and who felt inclined have traded already and the stimulus looks like it has run its course. When it ends, motor manufacturers will do what they can to fool the public with false bargains. I'd guess that by the 3/4 of 2010, when YOY growth will be compared against months with positive impact from scrappage, that contraction will return to the auto industry, and with it contraction in the UK economy as a whole.

The UK has a general election in May. A cynic may think that the recovery has been finely engineered to benefit the incumbent Labour Party. **In my last post** I gave a gloomy prognosis for the economy and energy prices and nothing has happened since then, apart from stubborn optimism in the markets, to make me change my mind.