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Road Could Get Worse for Detroit

New Fuel, Housing Pressures on Buyers May Depress Auto Sales Even More

By MIKE SPECTOR
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A growing number of warning signs could point to a tougher-than-expected U.S. auto-sales environment this year, pressuring Detroit's efforts to cut costs and overhaul product lines to meet shifting consumer demand.

This year already was expected to be a slow one for U.S. auto makers and was even expected to post challenges for some of their Asia-based rivals. But further indications of a housing slump, a recent rise in gasoline prices and weakness in car-crazed California could add extra weight in the year's first half, say some industry observers.

- **The Outlook:** Some observers say 2007 could be an even tougher year than expected for U.S. auto sales.
- **The Reason:** The public's appetite for cars is influenced by the housing market, which has weakened, and the price of gasoline, which has risen in recent weeks.
- **The Impact:** A weak year could put more pressure on Detroit's Big Three auto makers to restructure as Asia-based rivals continue to secure market-share gains.

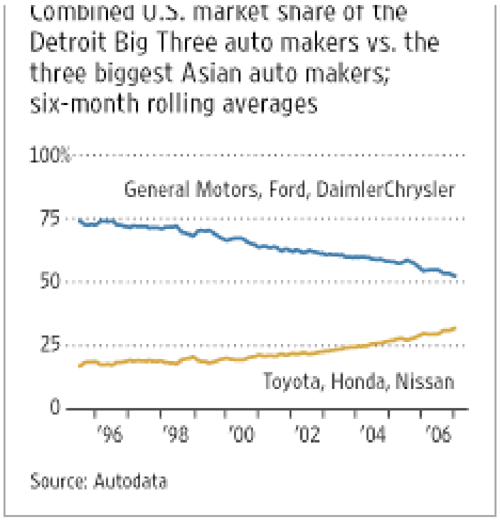
In an automotive outlook report this week, IRN Inc., a Michigan market-research firm, predicted an economic slowdown in 2007 and says "sufficient evidence" supports a recession sometime this year. "Look for other analysts and the Big Three auto makers to make some significant reductions by the second quarter regarding their outlooks for 2007," it said.

"The automotive outlook is too high" on Wall Street, said Erich Merkle, IRN's forecasting director, in an interview. Citing a drop in housing starts and rising durable-goods inventories, he added, "I think that there are a lot of folks out there that have yet to account for the possibility of a significant slowdown in economic performance as 2007 unfolds."

IRN reduced its 2007 sales forecast in December to 16.1 million cars and trucks from 16.3 million. That number could go lower, Mr. Merkle said. Last year's sales totaled 16.6 million, according to Autodata Corp. Analysts and economists who forecast car sales are considering economic indicators, but most have stuck with their predictions.

U.S. auto-sales data for February, to be released today, could indicate the degree of the market's softness. **General Motors** Corp. and **Ford Motor** Co. are expected to report drops from year-ago levels because of some weakness in retail sales and fewer sales to rental-car companies. Chrysler, engrossed in a new restructuring plan and speculation it may be sold by parent **DaimlerChrysler** AG, warned in a recent conference call that sales were down in February and encouraged dealers to make a push in the month's final week.

Domestic brands' market share, already declining, could drop below 50% for the first time. Their retail share, which excludes



fleet sales, has been below 50% for some time. Analysts expect **Toyota Motor** Corp. and **Honda Motor** Co. to report stronger February sales than a year ago.

Depreciating homes deprive homeowners of equity often used to finance new vehicle purchases. And slower home construction damps sales of high-margin pickup trucks, Detroit's most profitable vehicles.

Difficulties continue in California, the nation's largest auto market. At Galpin Ford, a dealership in North Hills, Ford-brand car and truck sales are down about 4% for February. "I think California has had it the toughest for the last number of months," says Bert Boeckmann, the dealership's owner, adding that other nearby domestic dealerships have fared worse.

January's home sales were California's slowest since 1998, according to DataQuick, a real-estate research firm. Median home prices are up 2.4% from January of last year, but down 2% from December. Slowing construction, meanwhile, promises to correct the housing market by reducing inventories, but it could take some time to bottom out.

"People are so anxious to call housing as stabilized. We don't see it that way," says George Pipas, Ford's top sales analyst. Mr. Pipas expects that sales of Ford's top-selling F-Series pickups could bottom out at 750,000, lower than last year and well below the more than 900,000 trucks Ford sold in 2005.

Fuel prices also are on the rise, posing a potential obstacle for Detroit's most profitable pickups and sport-utility vehicles. The average U.S. retail price for gasoline reached $2.38 a gallon this week, according to the Energy Department, well below the $3 a gallon reached last summer but the highest price since September.

Market forces could pinch foreign car makers as well. Market pressure in California is "manifesting itself in the Asian imports," said Jeffrey Rachor, chief operating officer for **Sonic Automotive** Inc., during an earnings conference call. Increased competition in the gasoline-electric hybrid segment, where demand is slowing, caused Toyota in January to start offering incentives on the Prius for the first time.

Jim Farley, the head of Toyota's U.S. sales operation, told reporters at the Chicago Auto Show last month that the auto maker needs to set the Prius apart in an increasingly competitive segment. The auto maker also expects some head winds later this year when a government regulation recalculates the Prius's fuel economy rating to around 45 miles per gallon from 60.

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