{ CAR LEASING }

JEREMY WARNER

Using credit to buy cars is ubiquitous – and an economic pile-up in the making

Of all the adverse consequences of the financial crisis, perhaps the most pernicious has been its depressing effect on earnings growth. All these years later, and in the UK real wages remain far below their pre-crisis level. According to recent forecasts by the Institute for Fiscal Studies, inflation-adjusted earnings are unlikely to get back to where they were prior to the crisis until at least 2021. This would make it the longest such hiatus in wage growth in more than 100 years.

Perhaps oddly, however, this doesn't seem to have had much effect on consumption, at least in the UK and the US, where there has been strong household spending growth for some years now. And, in particular, it has so far had zero effect on new car sales, which again both in the UK and the US, have been hitting repeated record highs.

Nor is this because, as has been the case with some other big-ticket items of consumer spending, prices have been falling. In fact, auto prices have been rising quite steeply with newer and more expensive models the purchase of choice for many consumers.

How can they afford these outlays? The question is answered in a single word: credit. Around 90% of cars sold today are purchased via personal contract plans (PCPs). That represents a steep growth compared with 10 years ago, when less than half of car purchases were funded this way.

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That growth is, in itself, salutary; no other area of consumer credit, including credit cards or personal loans, has grown as fast. In the UK last year, £40bn of car loans were extended, which means that after mortgages, PCPs are the second-biggest form of consumer credit. The phenomenon is proportionately even bigger in the US.

The simple reason for all this is the steady increase in car prices. The average car today costs around £20,000. Other charges associated with running a car – insurance and tax – have also been rising steeply. Normally, such a purchase would be a massive financial burden that few people are able to save up for. Enter PCPs. You may think you own the car; in fact, you are in essence merely renting it.

Auto manufacturers and finance companies are as enthused by this now quite well-established way of doing business as the consumer. It both helps the industry sell a lot more cars, and it offers finance providers what they like to think of as a relatively risk-free way of expanding consumer credit. Now, where have we heard that before? Whenever bankers claim to have found the holy grail of 'riskless' lending, it's time to start worrying.

At the end of your contract, you either roll the arrangement over into a new one, buy out the outstanding value of the car or, more usually, hand back the keys and start again with another, newer model. The risks are obvious. In the US, which tends to front run the UK by a year or two on most matters economic, leased cars and trucks are being returned in record numbers so as to trade up to newer models, producing a glut of vehicles in the second-hand market, which is sharply depressing prices.

This, in turn, interferes with the assumptions on which the credit is based, threatening losses on many such contracts. In combination with record-low interest rates, personal contract purchases have helped push a seven-year stretch of increased US automobile sales, the longest such period since the launch of the Ford Model T in the late 1920s. It's beginning to look like a giant Ponzi scheme. We'll see how it all ends, but badly seems like a pretty sure bet.

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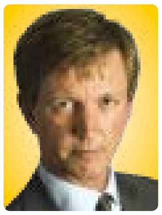

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