How will COVID-19 shape used car markets?

Scenarios for post-coronavirus economic recovery

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Autovista Group

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Signs are emerging that the Chinese government may have contained the coronavirus (COVID-19). The country looks to be emerging on the other side of peak infections while the rest of the world stands at the beginning of a very dynamic development.

Severe measures implemented in Italy are now hinting at the beginning of a flattening of the curve of infections. In Germany, strict measures implemented by the Government a little over a week ago, have not yet resulted in a substantial slowdown of infection rates. The US has just surpassed China in the number of infections and the states of New York and Louisiana are particularly hard hit. In India, the biggest citizen lockdown has been implemented, affecting a population of 1.3 billion.

Elsewhere, countries appear ill-prepared to cope with the potential impact that the virus will have on their societies. For most, business activity has largely come to a stop. However, there is ample monetary and fiscal support, most notably the $2 trillion from the US Government, which has effectively doubled public debt. Stock markets have reacted positively over the past few days to monetary and fiscal stimuli. The Dow Jones Industrial Average index rose more in one day than ever in its history. However, the situation remains far from being contained and the full extent of the implications that COVID-19 will have on economies and societies has yet to emerge. Significantly, on 27 March there was another substantial downward correction on stock markets. It would seem that China could be heading towards producing items that no one in the west will be in a position to buy under the strict regimes to combat infection. This would be a risk for the Chinese economy.

As forecast providers, we are challenged by these developments like anyone else. We have mapped out various scenarios, which we will update regularly as assumptions are adjusted and more robust data emerges. We will start with coverage of the Big 5 European markets France, Germany, Italy, Spain and the UK, with additional markets to follow.

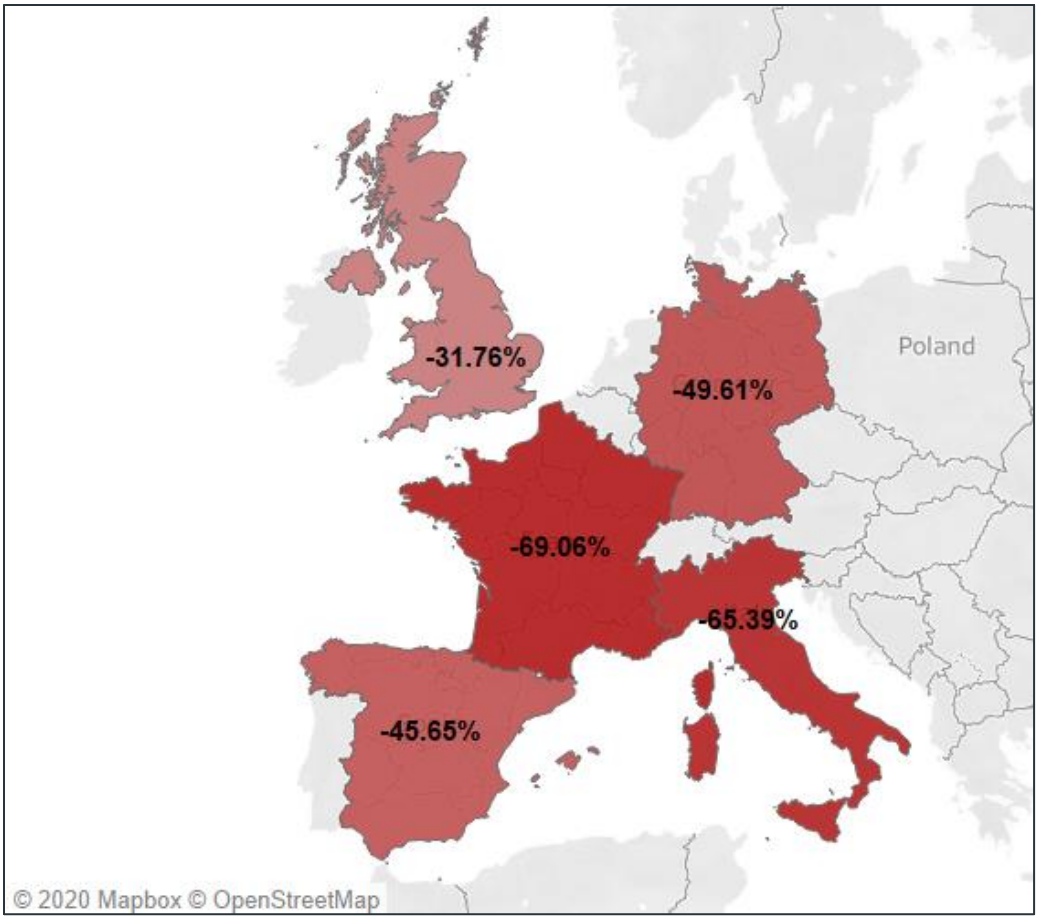
Dealer activities at a halt

Markets are reporting a standstill, as dealers are closed and economic activity has largely come to a stop. These developments are also visible in our data.

Activity on portals has halted and the number of used cars sold via them (Figure 2) has dropped by 65% between 16 and 23 March in Italy.

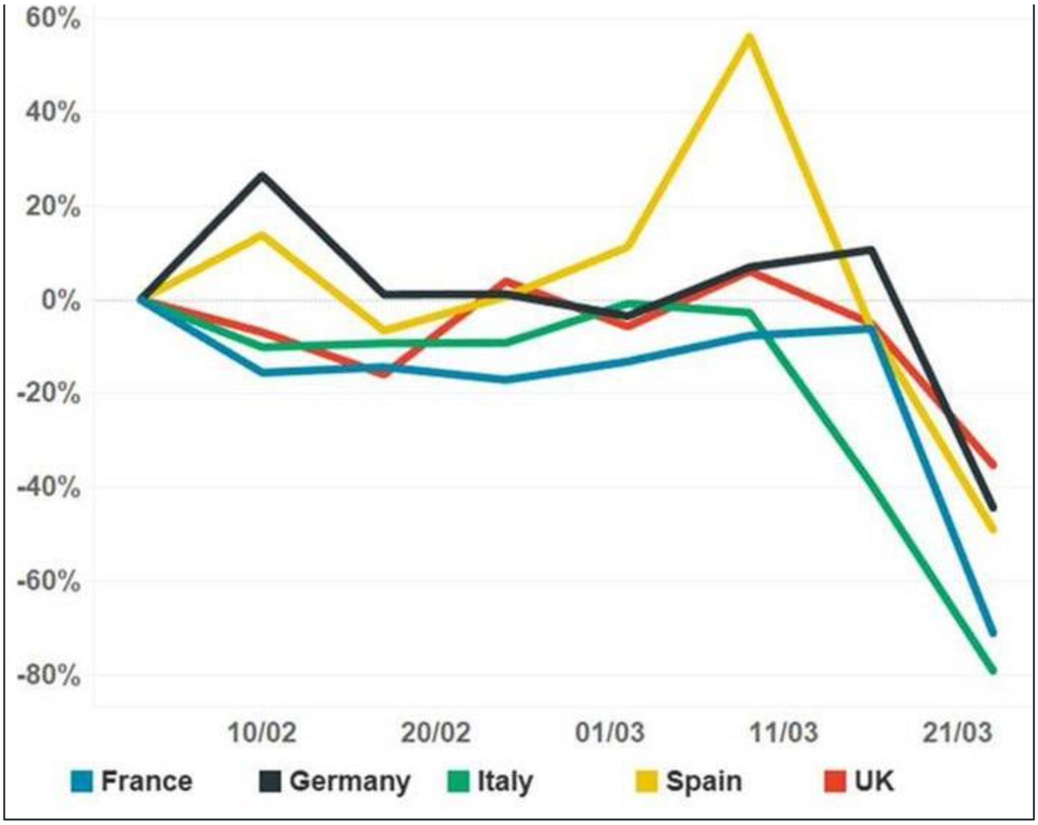
In the UK, which was late in implementing severe measures to combat the virus, the number of cars sold experienced a 32% decline during the same period. In France, Germany and Spain the decline is between 45% and 69%, also correlating with the extent and timing of the lockdown.

We expect these numbers to worsen substantially over the coming weeks as the short-term demand shock will become even more visible and dealerships remain closed with too little activity on the e-commerce front.



Source: Autovista Group

Figure 2: Weekly change in used car sales since the beginning of February 2020



Source: Autovista Group

Pricing heading down

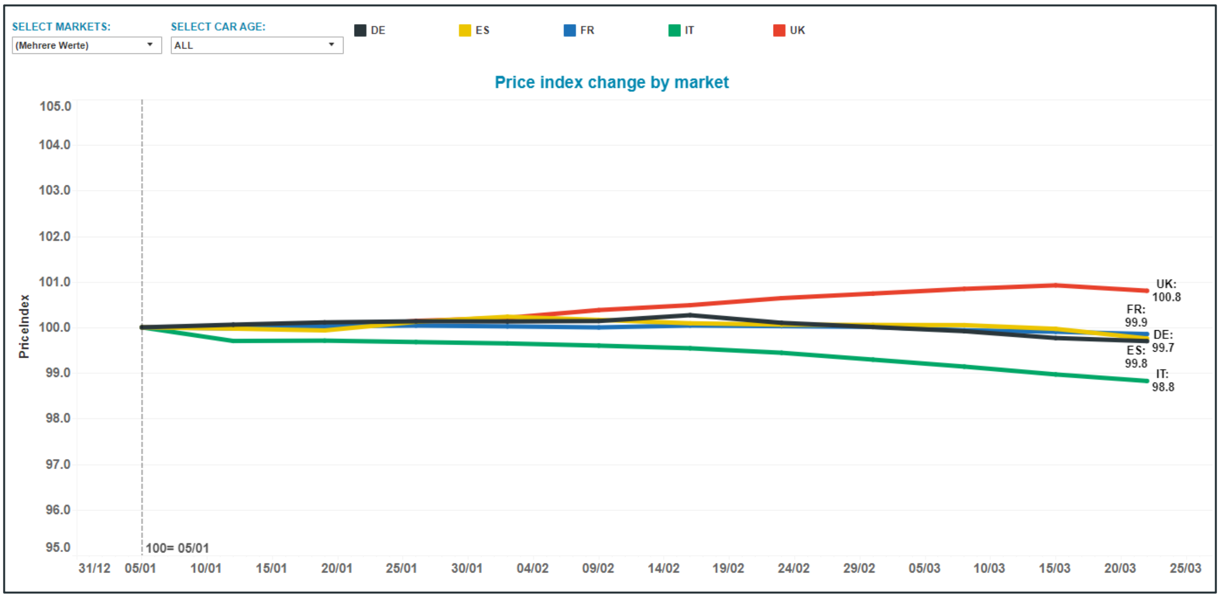
In our used-car pricing data, we see only the most gradual decline in RVs between the beginning of February 2020 and today (Figure 3) but this is expected to change.

The reasons behind this gradual decline are two-fold:

- The index is based on changes in market observations over the past 30 days and gives greater weight to more recent changes; nevertheless, there is a slight lag in the most recent changes being visible; and
- We are just at the beginning of a very dynamic development and many dealers have not adjusted prices downward on the portals. This is either because they are closed or feel that there is no particular need to make adjustments at this point, as customers are not currently looking to purchase a car.

Nevertheless, we see the beginning of a trend forming. Prices in Italy, where the lock-down has been in place for the longest period, are dropping slightly more than prices in other continental markets from February until March. In the UK, prices are rising slightly, but this is due to reduced supply of traditional internal combustion engine vehicles and improved demand for alternatively fuelled vehicles. Furthermore, the UK only truly entered lockdown following Prime Minister Boris Johnson's address to the nation on 23 March.

Figure 3: Development in the Autovista used car price index since 5 January 2020



Source: Autovista Group

Coronavirus scenarios - how swiftly will economies recover?

In order to assist with analysing the impact of the coronavirus on the automotive industry, we have developed a number of scenarios. The scenarios are based on risks associated with the following five mandatory parameters as well as other country-specific factors that influence residual-value (RV) development:

- How long until the spread of infections is contained;
- The economic outlook for 2020, 2021 and 2022;
- On the supply side, expected issues in the supply chain for new-car production;
- On the demand side, development of private consumption over the coming years; and
- An assessment of how effectively fiscal and monetary policy measures are working.

Whereas most Western European countries would have thought only in January or February that any slight economic dip could be recovered swiftly, this view has fundamentally changed. Towards the end of March 2020, most countries are still allocating the highest probability to a low-medium risk scenario for used-car values. We call this scenario "moderately-quick V-shaped recovery".

Within this, we expect a sharp downturn of the economy during the second quarter, a V-shaped recovery towards the end of Q3 2020 and particularly good performance during Q4 2020, with some potential to compensate for the losses accumulating during Q2. For the full year 2020, this scenario works based on the assumption of year-on-year GDP growth of 0% to -2% in the Eurozone. But even in this scenario the Eurozone will not be fully back to its economic strength by the end of 2021.

France is already more pessimistic in its assessment of the situation, but other European countries are also assigning substantial probability to the more pessimistic "slow, U-shaped recovery" scenario. In this scenario, we still expect a full recovery of economic activity during 2020 but the pandemic will cause longer social and economic disruption. The economy will only gradually pick up speed and economic activity will only be restored towards the end of the year. Under these circumstances, a recovery would more likely be U-shaped.

The UK is most pessimistic about the economic consequences of the combination of coronavirus and the Brexit aftermath. There is little trust in how the UK government has been dealing with the crisis and whatever pent-up demand there may be, the fragility of the economy is hugely concerning. Our Glass's UK editorial team allocates 75% probability to a "deep recession, slow recovery" scenario. That is one where it will take up to six months to gain control over the pandemic, where monetary and fiscal stimuli have hardly any positive impact on the economy and private consumption. As a result, economic growth in the UK will be negative in 2020 and 0% in 2021.

Impact on residual values

Despite stark pessimism in how the UK will digest the economic aftermath of the pandemic in combination with the Brexit negotiations, there is a positive note (Figure 4). The expected impact on used-car values in the UK is not as severe as in other markets even in this darker scenario. By 2021, the UK will have fully recovered in terms of used-car prices to levels close to today.

The main reason is the limited elasticity in the market, together with the fact that supply of new cars has dramatically reduced and is unlikely to ramp up again soon. The expectation is a continued supply shortage during the economic downturn. While the weaker British Pound is not helping, there is some pent-up demand containing the risks of further drops in used car values.

Table 1: Risk scenarios for the impact of coronavirus

	Low risk (5-7) "Swift v-shaped recovery"	Low-medium risk (8-10) "Moderately quick v-shaped recovery"	Medium risk (11-13) "Slow u-shaped recovery"	Medium-high risk (14-16) "Deep recession, slow recovery"	High risk (>16) "Very deep recession, l-shaped recovery"
France	5%	30%	**55%**	10%	0%
Germany	0%	**50%**	35%	15%	0%
Italy	0%	**45%**	35%	20%	0%
Spain	0%	**50%**	35%	15%	0%
UK	0%	5%	20%	**75%**	0%

Note: Each of the five mandatory, and one optional, parameters within each scenario contributes a country-specific risk score between one and five. The minimum risk score achievable is five and the maximum 30. The scenarios are built on risk scores. Countries have based their current probability on how likely it is that each scenario will emerge. The one that carries the highest probability is the base case for each market.

Source: Autovista Group

Head of content and product at Autovista's UK subsidy Glass's, Anthony Machin said: "Across the world, the automotive industry faces unfamiliar challenges. In the UK, after a strong start to 2020, like many around the world the car market is closed as the population adapts to new ways of working, socialising and shopping."

France and Italy expect the biggest hit on used-car values to occur in 2021, after a more moderate decline in 2020 (France -1.5%; Italy -0.5%). Both expect the supply shortage of new cars to soften the blow. The full effect of the crisis should be visible during 2021. Italy is particularly exposed to the coronavirus pandemic dragging into a full-blown economic crisis that will impact private demand for used cars for a longer period.

France is even gloomier about the economic challenges in 2021, which is why the expected drop in RVs is the highest among the Big 5 European countries. In neither market is a recovery of RVs expected during the period under review.

Germany sees the biggest drop in RVs occurring in 2020 (-2.2%). There will already be a small recovery in 2021 and then stabilising in 2022 at a level down 1.7% vs. March 2020 values. The expectation is that Germany will come out of the crisis more swiftly as private consumption will support the economy.

Spain will see a substantial drop in 2020 of 3% versus March 2020 values and that drop will remain stable also in 2021. Even in 2022, residual values will not have fully recovered. One of the main reasons is the very strong RV performance in Spain during the past few years. The downward correction will therefore be slightly more pronounced and drag on for a longer period despite the expected economic recovery.

Changes and developments

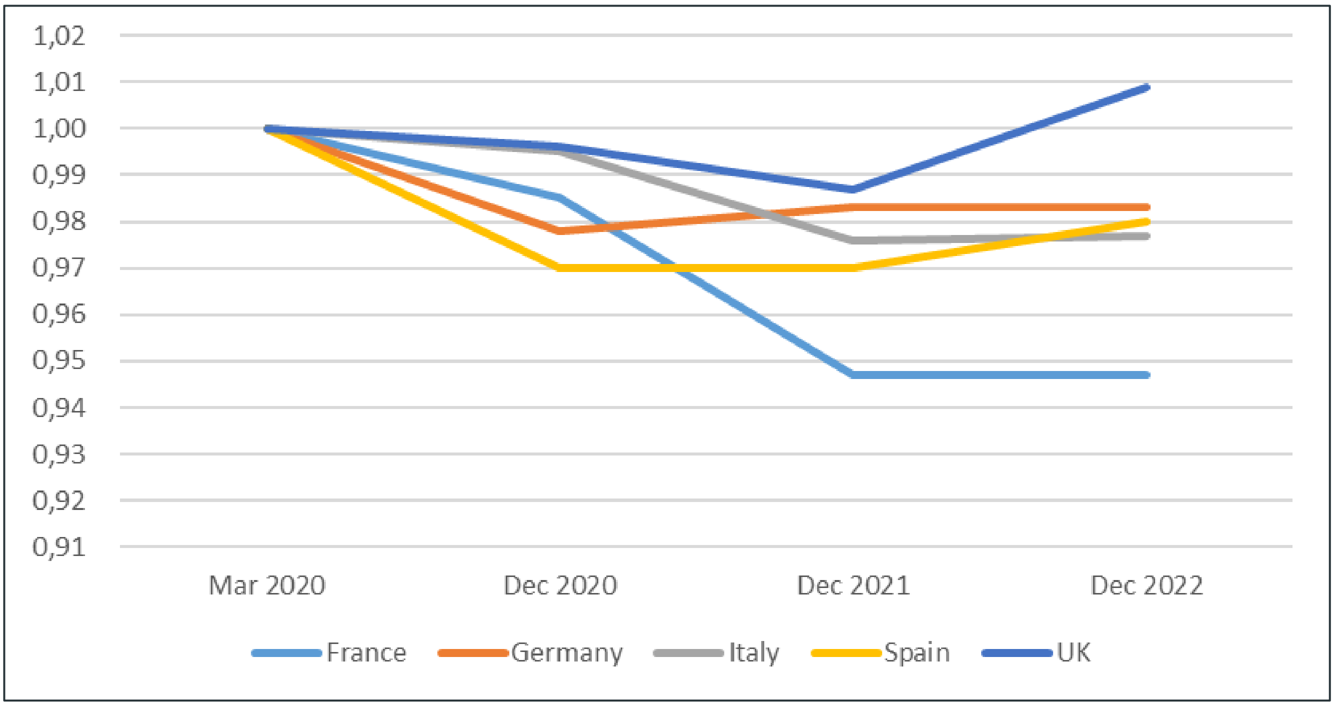
Table 2: Forecast percentage change in residual values between March 2020 and December of the relevant year for the highest-probability scenario

	2020	2021	2022
France	-1.5%	-5.3%	-5.3%
Germany	-2.2%	-1.7%	-1.7%
Italy	-0.5%	-2.4%	-2.3%
Spain	-3.0%	-3.0%	-2.0%
UK	-0.4%	-1.3%	0.9%

*Note: The values shown in table above are percentage changes (not percentage point changes) in RV between March 2020 and December of the relevant year. For example, the RV in March 2020 is 10,000€ or 48% of the list price, the RV in December 2020 is 9,780€ or 46.94% (10,000€*0.978, respectively 48%*0.978). This results in a change of -2.2%.*

Source: Autovista Group

Figure 4: Indexed percentage change in residual values between March 2020 and December of the relevant year for the highest-probability scenario



Source: Autovista Group

Conclusion

It is too early to draw a line under the analysis of what impact the coronavirus will have on societies, the economy and used-car markets. During the 2008/2009 financial crisis, we saw falls in RVs that were substantially higher than what our most probable scenarios currently forecast. At the time, declines of 12% on average across segments built up over 12-18 months into the crisis.

We are currently far from expecting this level of impact on used-car markets, as indicated in our risk scenario probabilities and RV forecasts.

Several things are different this time: Eurozone governments have taken much stronger policy actions against the collapsing demand, the current economic shock is not paired with a lack of financing opportunity and after the peak of the crisis, we should see some pent-up demand as private consumers will regard the shock as temporary.

There are some mildly positive signs emerging in that the numbers of daily infections appear to be easing in the most affected European markets. However, the US, South America and many developing countries are at an earlier phase of the pandemic and will have to implement the same dramatic measures to contain development, with continued sizeable effects on economies around the world.

As the pandemic plays out, we will update this coverage, see how assumptions and scenarios evolve and how quickly and extensively the used-car market adapts.

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