



Accelerate *Your Business*

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## SUMMARY

Wholesale used vehicle pricing and the health of the retail market have been, and will continue to be, buffeted by new vehicle inventories in the near term. The more lasting impact on the market, however, will be applied by the future direction of overall consumer spending.

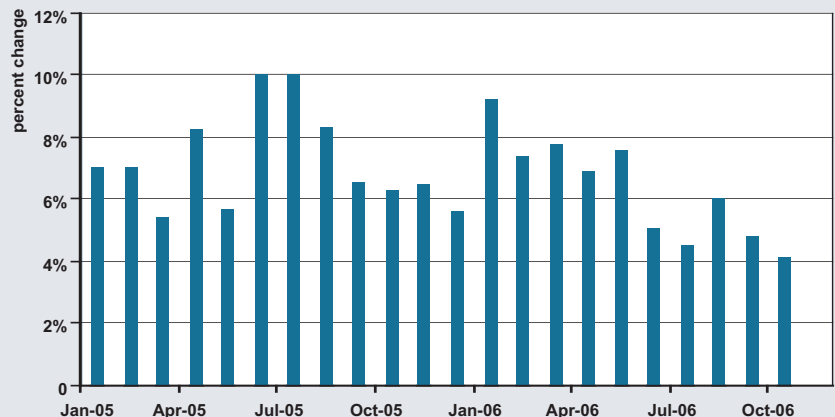
## WILL CONSUMERS RETRENCH?

In the first three quarters of 2006, real GDP slipped from 5.6 percent to 2.6 percent to 1.6 percent, due in part to a slowdown in housing and a deteriorating trade balance. Personal spending and business investment actually held up well through the first nine months. With any turnaround in housing over a year off and auto production cuts set to continue into 2007, the economy's fate will remain in the consumer's ability and willingness to spend.

October retail sales reports were mixed, with a slight leaning to the negative. Clearly, analysts were premature in dismissing Wal-Mart's earlier poor performance as a case of tactical and strategic issues specific to that company. Basically, it was only mainstream department stores that reported significantly higher sales in October (and that, in part, due to easy year-ago comps). So, the question becomes—"will Holiday sales be Ho-Ho or Ho-Hum?"

### Retail Sales—Still Solid, But Slowing

Year-over-Year Percent Change in Retail Sales



Source: U.S. Bureau of Census



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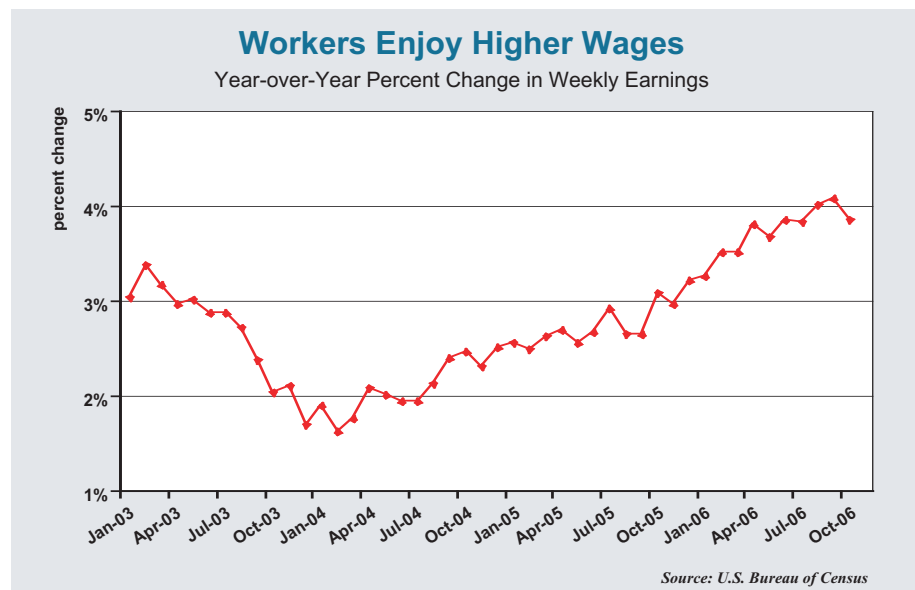
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## JOB STRENGTH AND WAGES GAINS SAY “NO RETRENCHMENT”

**The unemployment rate in October fell to a five-year low (4.4 percent)** and initial jobless claims continue to hover around their cyclical low point. Simply put, the labor market is tight, as witnessed by an unemployment rate of less than 2 percent for anyone with a college education.

**The tightness has led to wage gains.** Average hourly earnings are up 3.9 percent over the past year and total wages and salaries are up 7.6 percent. And, if there is one thing that we can take for granted, it is that households will spend all of that extra income. Unfortunately, a sizable and growing portion of that spending will be used to pay for *past* purchases.



## HIGHER DEBT SERVICING COSTS SAY “RETRENCHMENT”

**As stated last month, we believe that the housing correction in terms of starts, resales, and pricing has begun to show us where the bottom will be and that the initial negative shock to the economy is over.** This month we were joined in that assessment by none other than Alan Greenspan.

The problem is that the dampening effect on consumer spending will likely be very drawn out. No upturn in housing is seen until 2008, and the current correction has altered the consumer’s availability and cost of credit for the long-term. Home equity lines (a significant support to the overall economy), new vehicle sales, and—in an indirect way—used vehicle sales have been tapped out. Adjustable rate resets will peak in 2007, and recent statistics suggest some consumers have shifted to credit card debt to support their spending. Substituting long-term, below-market-rate debt with high-cost, short-term debt is not a formula for growing future household discretionary income.

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## Overtime Hours

**Out-of-favor, but not irrelevant.** National employment statistics are released monthly. The growth in non-farm payrolls, the unemployment rate and sometimes hourly earnings garner headlines and often move the stock and bond markets.

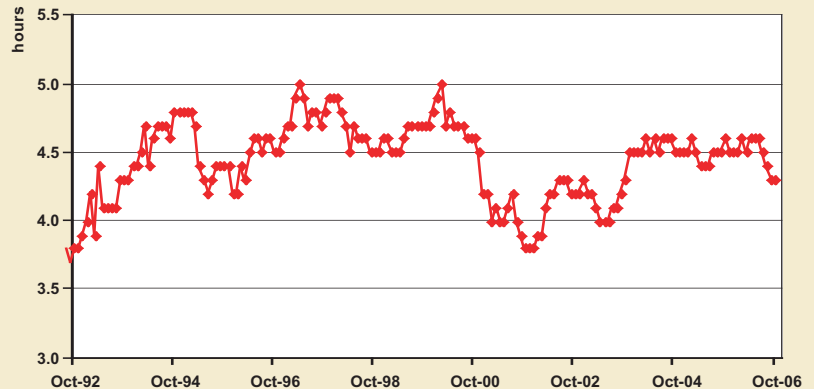
Weekly overtime hours in the manufacturing sector are included in the monthly employment report. Decades ago it was a closely watched statistic, but as manufacturing diminished as a share of total employment, so, too, did interest in overtime hours.

**Why do we follow overtime hours?** We believe there is a strong theoretical underpinning to the correlation between overtime hours and the vitality of the used vehicle market. Mainstream America does not receive the bulk of its income in stock options and year-end bonuses; thus, overtime pay is important to potential used vehicle buyers. Additionally, "official" overtime in the manufacturing sector serves as a proxy measure for the ability of trades people, both skilled and unskilled, to secure side jobs and off-the-book pay.

**Overtime hours continue to suggest a strong labor market.** In 2001 and 2002, average overtime hours were significantly below their historical average. Not unrelated, wholesale used vehicle pricing was weak. Average overtime improved in 2003 (as did used vehicle pricing) and has remained in the 4.3 to 4.6 hours range ever since.

### Overtime Hours Slip, But Remain Relatively High

Average Weekly Overtime



Source: Bureau of Labor Statistics

## MANHEIM USED VEHICLE VALUE INDEX

**Prices inch up in October, but show first year-over-year decline in two years.** Wholesale used vehicle prices (on a mix, mileage, and seasonally adjusted basis) inched higher in October. Absent the seasonal adjustment, auction prices declined in October, as they invariably do. The October Manheim Used Vehicle Value Index was down 0.4 percent from its year-ago level. It was the first year-over-year decline in the Index since October of 2004, due in part to the comparison being made against a very strong pricing environment in 2005.

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For the past several months, wholesale used vehicle prices have moved in a fairly narrow range as the negative impact of excessive carryover inventory offset the beneficial effect of low unemployment and good credit availability.

### Wholesale Prices Inch Up in October

Manheim Used Vehicle Value Index – January 1995 = 100



Source: Manheim

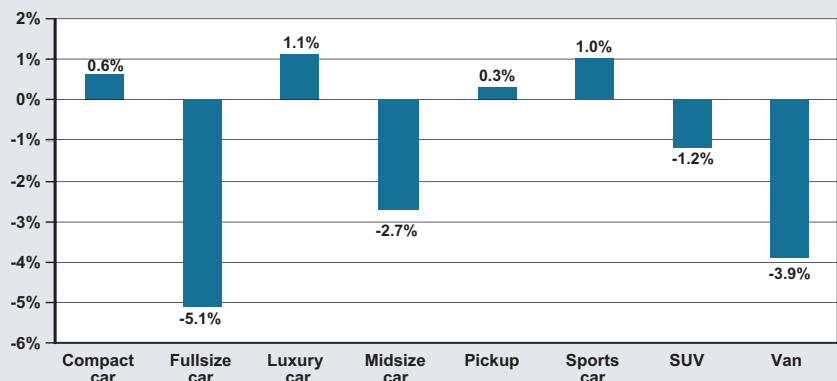
**Newer-model used vehicles weaken in October in face of new vehicle market pressure.** The importance that new vehicle inventory has played in recent auction pricing trends is revealed by looking at the sales for various consignor types. For example, although overall wholesale prices were relatively flat from October to October, prices for off-rental units were lower. Auction prices for risk units were down 3 percent on a mileage-adjusted basis. Program rental car prices were down substantially more, although aggregate price comparisons are difficult due to significant make/model shifts between 2005 and 2006.

**Meanwhile, commercial fleets units—less impacted by the competitive pressure of the new vehicle market—enjoyed year-over-year price gains at auction.** Over the past year, the mileage-adjusted price for a mid-size commercial fleet car sold at auction was up 1.5 percent—and that’s against very strong pricing last year.

**Within the market segments, full-size cars fell further in October.** As noted last month, these units are a small share of total auction volume and the segment is dominated by off-rental units. (Vehicles from the 2006 and 2005 model year accounted for approximately half of all full-size cars sold at auction in October of 2006.)

### Wholesale Prices for Large Cars Weaken in October

Percent change in wholesale prices – October 2005 to October 2006



Source: Manheim

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**Q. The mid-term elections showed a sizable shift in the balance of power between Republicans and Democrats. Does this tell us anything about the state of consumer attitudes or possible future economic policy changes?**

**A.** More so the former than the latter. Although the Iraq situation spurred much of the electorate's angst, economic conditions also played a role. Note, for example, the strong tide of anti-incumbency in those states where the auto industry slowdown produced pockets of economic weakness.

As to future economic policy, any changes will be muted and delayed. In the near-term, our concern would be whether stability in the trade and currency markets is maintained. We are a global economy and the daily flow of international capital is enormous and volatile. As a result, Treasury Secretaries and Federal Reserve officials use carefully guarded speech to avoid roiling the markets. Politicians, however, freely bandy about terms like "unfair trade" and "currency manipulation" with little regard for the repercussions.

**Q. Our auction has enjoyed an increase in consignment from rental car companies. Is that typical of the industry as a whole? Is there a potential for a glut of these vehicles in the future?**

**A.** Rental risk units being sold at auction have begun to increase across the board and that will continue into 2007 and beyond. As the domestic manufacturers pulled back from offering extensive buyback programs, rental car companies had to buy more risk units. As such, the companies are now responsible for remarketing a larger portion of their fleet. This provides an ideal opportunity for our auction and corporate personnel to provide consultative remarketing services and advice to our rental car company clients.

Since the increase in risk units will be accompanied by a decline in program units, there is no threat of a glut. In addition, the continued success of Certified Pre-Owned sales should keep demand for the off-rental units high. Rental companies that make wise decisions on model and option selection, length of service, and proper reconditioning will achieve strong prices on their end-of-service units.

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