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BLUE BOOK Market Report
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In This Issue:

Kelley Blue Book Public Relations Contacts:
Robyn Eagles | Director, Public Relations
949.268.3049 | reagles@kbb.com
Joanna Pinkham | Senior Public Relations Manager
949.268.3079 | jpinkham@kbb.com
Brenna Robinson | Public Relations Manager
949.267.4781 | berobinson@kbb.com
Adair Ahlers | Public Relations Coordinator
949.268.2755 | aahlers@kbb.com

MARKET ANALYSIS:

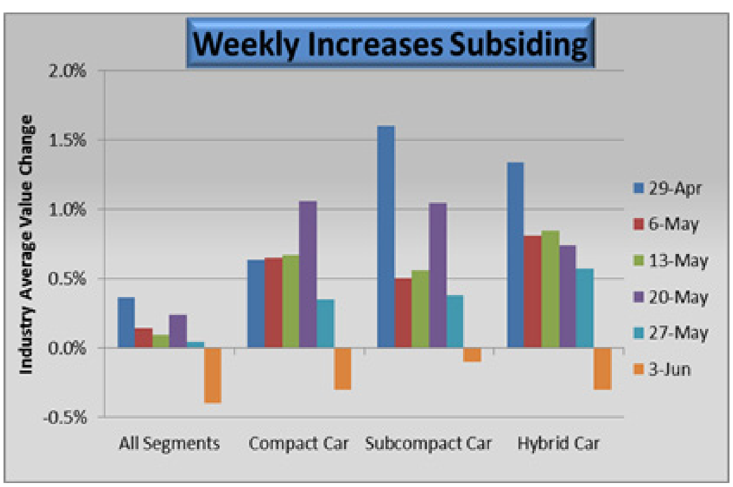
Bulletproof Fuel Sippers Start to Drop

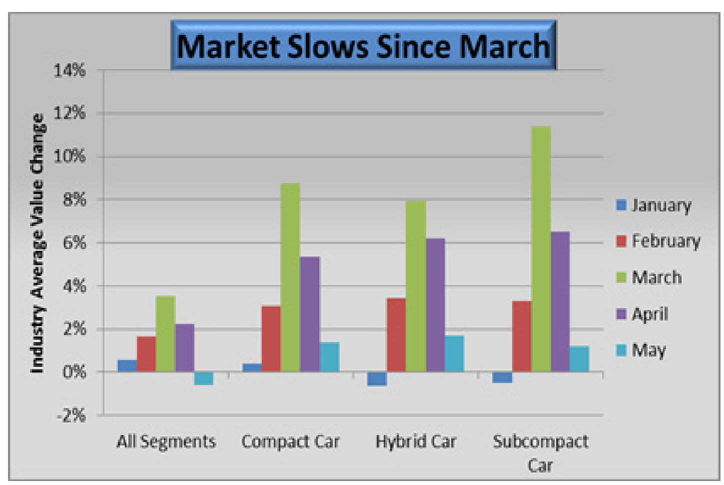
- Alec Gutierrez, manager of vehicle valuation, Kelley Blue Book

Used-vehicle values peaked in May, dropping a slight 0.6 percent for the month; the first monthly decline posted since January. Continuing to outpace the rest of the market, fuel-sipping compact and hybrid vehicles increased an additional 1-2 percent, capping off another positive month during the hottest used-car market since 2008. In some cases, values for fuel-efficient one- and two-year-old vehicles have jumped more than 30 percent and are even approaching original MSRP. Kelley Blue Book analysts believe that values for fuel-efficient vehicles are not sustainable at current levels and we believe values will decline as we head into summer.

	YTD Change		May Change		Week Ending 6/3	
Segment	$	%	$	%	$	%
Subcompact Car	$2,200	22.0%	$150	1.2%	($25)	-0.1%
Compact Car	$2,250	21.4%	$175	1.4%	($50)	-0.3%
Hybrid Car	$3,000	20.4%	$300	1.7%	($50)	-0.3%
Industry Average	$950	5.4%	($100)	-0.6%	($75)	-0.4%

Although values increased slightly in May, the rate of appreciation has been on the decline since March. In fact, during the past several weeks Kelley Blue Book analysts have seen values decline across all segments, even among fuel-efficient segments which had increased for 20 consecutive weeks.





The majority of the used-car market strength has been driven by the rapid rise in gas prices since the beginning of the year. Gas prices peaked in May with a national average of $3.98, and have since declined steadily to $3.78. Kelley Blue Book analysts expect values of fuel-efficient vehicles to slip an additional 3-5 percent through summer, and even more if gas prices continue to decline. It should be noted that we do not expect values for these vehicles to repeat the 25-30 percent declines witnessed in 2008, unless gas prices fall significantly. Regardless of where values end up, these vehicles will remain a smart purchase for budget-conscious consumers. With that said, our advice to dealers and consumers alike is to purchase with caution today, since values are likely to continue to fall through the early part of summer.

Truck and SUV Values Continue to Slip

Although overall values dipped only slightly in May, there were several truck segments that declined more significantly. As gas prices approached $4.00 per gallon in early May, values for fuel-thirsty trucks and SUVs continued to decline. Values dropped an additional 2-4 percent during the month, building upon the depreciation that began in March. Although values have been slipping, they do not compare to the significant drops that took place in 2008 when values for full-size trucks and SUVs declined more than 30 percent in response to rising gas prices. Since the beginning of the year, values for full-size trucks and SUVs are only down between 3-5 percent.

	YTD Change		May Change		Week Ending 6/3	
Segment	$	%	$	%	$	%
Full-Size Truck	($1,000)	-4.8%	($500)	-2.3%	($75)	-0.4%
Full-Size SUV	($1,200)	-4.6%	($1,200)	-4.4%	($300)	-1.1%
Mid-Size SUV	$0	0.0%	($450)	-2.3%	($175)	-0.9%
Industry Average	$950	5.4%	($100)	-0.6%	($75)	-0.4%

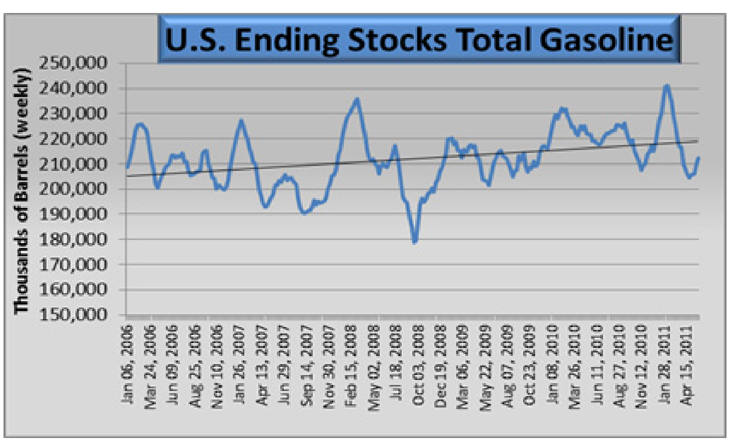
Significantly reduced sales of new trucks and SUVs over the past several years have resulted in a sustained supply reduction that has kept values strong since the severe declines of 2008. As we head into summer, fuel prices will play a significant role in truck and SUV values. With fuel at $3.78 per gallon and falling, we do not expect values for trucks and SUVs to decline more than an additional 3-4 percent through summer, if at all. Although gas prices are on the decline, they remain relatively high so dealers should not focus their attention on stocking-up on trucks and SUVs today. By late summer, there may be better opportunities to purchase a truck or SUV at a bargain compared to today's values.

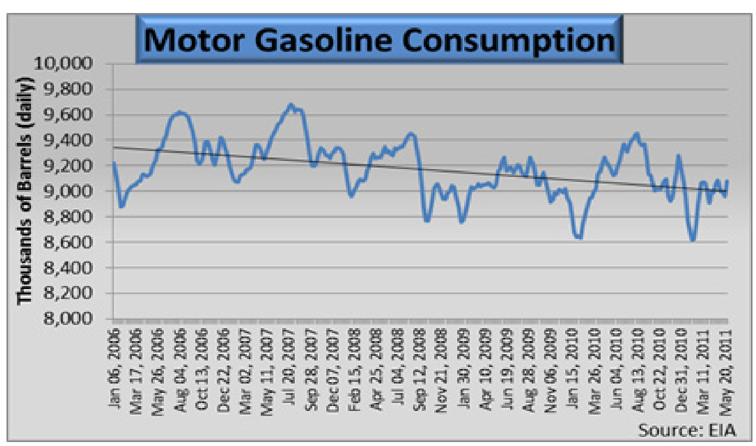
Fuel Price Declines Could Provide Relief for Consumers

Fuel prices have declined nearly $0.20 per gallon during the last several weeks, as oil futures have dipped more than $15 per barrel to around $98 today. Fuel prices are traditionally strong during the summer driving season, so the current decline in fuel prices is atypical for this time of year. With oil already well below its $114 high from earlier this year, prices may be due for additional drops. There are four factors that could potentially drive the price of oil down this summer:

1. OPEC oil production potentially increasing
2. Increasing U.S. gas and oil supplies
3. Declining U.S. gas consumption
4. A stalled U.S. economic recovery

OPEC meets on June 8, 2011, to discuss current oil production levels, and analysts already are pondering whether or not the group will decide to increase production. While an increase in production would certainly provide immediate relief to consumers, even if production quotas are held constant, gas prices still could drop based on the current supply and demand conditions of gas in the U.S.





Since 2006, motor gasoline supplies in the United States have been on the rise, while consumption has followed a downward trajectory. The May jobs report from the Bureau of Labor Statistics points to the potential for continued consumption declines. The unemployment rate increased to 9.1 percent, as only 54,000 jobs were created in the U.S. economy. This is far shy of the estimated 100,000-150,000 jobs needed to keep the unemployment rate flat. If the jobs situation continues to worsen, expect fuel consumption to remain flat or continue to decline. With supplies on the rise and consumption flat or declining, fuel prices are likely to continue to drop.

While no one can truly predict where gas prices will head next, there appears to be plenty of evidence to suggest that prices may break seasonal patterns and actually fall through summer. If prices continue to drop at their current rate we expect to see values for fuel-efficient vehicles continue to decline, while fuel-thirsty trucks and SUVs may stabilize. If gas prices drop below $3.00 per gallon, Kelley Blue Books expects values to drop 10-15 percent for fuel-efficient vehicles such as the Toyota Prius, Honda Civic and Nissan Versa. If fuel stabilizes at $3.50 or above, don't expect drops beyond 5 percent. In either scenario, values for trucks and SUVs are likely to stabilize if gas prices fall.

Demand Spillover Due to Japan Crisis Limiting Market Declines

While Kelley Blue Book expects values to soften in the short term, there still are supply concerns related to the earthquake in Japan that will limit the depreciation of vehicles most impacted by production stoppages. To date, production stoppages in Japan have only impacted values of one- to two-year-old used vehicles. Normally, as used vehicle values rise, new cars become more feasible alternatives, but due to reduced incentives and elevated new-vehicle prices, one- to two-year-old used car values have been able to press higher than in years past. Although used values only have been impacted on a limited basis, the same cannot be said of May retail sales figures.

	May-11	May-10	% Change	Total 2011	Total 2010	% Change
Detroit 3	526,325	520,241	1%	2,438,993	2,099,465	16%
Japan	323,077	416,662	-23%	1,920,700	1,802,628	7%
Europe	105,013	85,664	23%	456,567	386,136	18%
Korea	107,426	80,476	34%	463,648	342,740	35%

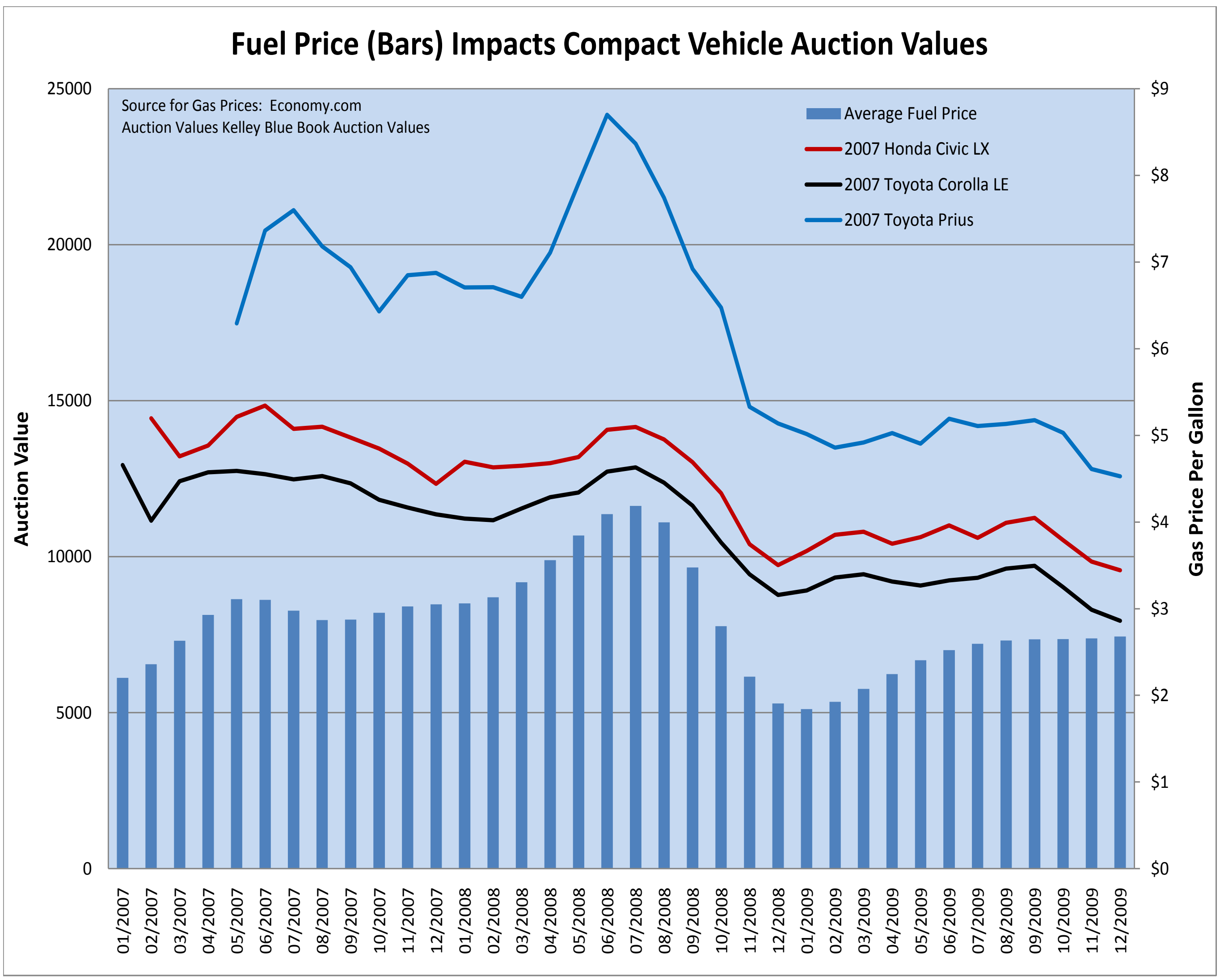
Japanese manufacturers posted a 23 percent decline in year-over-year sales in May 2011, although they remain up year-to-date. Manufacturers not severely impacted by the earthquake have continued to perform well, with many brands posting positive gains in May. The decline in Japanese sales was staggering enough to drop the SAAR significantly for the month of May. The industry SAAR figure came in at an 11.78 million pace, a considerable decline after three consecutive months of a sales pace in excess of 13 million units. If Japanese production remains low, prices for new Japanese vehicles will remain high, potentially shifting market share to American, Korean or European manufacturers. Used vehicles also should see an increase in demand as incentives continue to drop across the industry and new-vehicle prices remain high. However, the effect of the crisis may be short lived, given the already impressive strides the Japanese automakers have made toward recovery. By fall, we expect the supply situation to be resolved in most cases, at which time new-vehicle prices should subside.

62 MPG: A Bridge Too Far?

- Eric Ibara, director of residual value consulting, Kelley Blue Book

Debate continues about the appropriate level for future Corporate Average Fuel Economy (CAFE) standards. As it currently exists, CAFE requirements increase to an average of 35 mpg in 2016, a boost of about 23 percent more than current standards. In spite of the improvement, this is not sufficient for some environmental groups who are lobbying for an increase to 47 mpg or even 62 mpg by 2025. Automakers, on the other hand, fear that legislation will require technology so expensive that sales volumes will be limited. Another risk is that car companies will be required to manufacture vehicles that don't meet consumer needs. The trend toward smaller, fuel-efficient vehicles already has begun, as more compact, sub-compact, hybrid and electric vehicles are primed to enter the market during the next few years.

One lesson learned from the 2008 run-up in gas prices is that consumers are sensitive to the price of fuel. As prices edged closer to $4 a gallon, the demand for fuel-efficient vehicles shot up. However, it was somewhat surprising to see the interest in these vehicles plummet along with the price of fuel. As the accompanying chart shows, as soon as gas prices dropped, consumers traded in their economy cars and went back to large SUVs. Full-size truck and utility vehicle prices rose to historic levels and have remained above average to-date. The conclusion from this activity is that consumers move to fuel-efficient vehicles when there is an economic need, but they prefer larger, more comfortable vehicles when they can afford them.



While this is hardly a revelation, a problem arises when mathematics are applied to the facts. Assuming an average person drives 15,000 miles per year, converting from a vehicle that gets 20 miles per gallon to one that gets 30 miles per gallon saves 250 gallons of gas a year. Even with gas at $3 a gallon, this would save $750 annually or $3,750 over five years. While this is not enough to justify the premium for some hybrid models, when the added convenience is factored in (less trips to the gas station) or access to an HOV lane is considered, the upgrade could be justified. However, with every successive improvement in fuel efficiency, the amount of savings becomes increasingly smaller. By the time a consumer is considering an improvement from a vehicle that gets 50 mpg to one that gets 60 mpg, the annual savings is only 50 gallons. Even at $5 a gallon, this is only $250 a year.

	Miles Per Gallon Improvement			
	20-30	30-40	40-50	50-60
Gallons Saved	250	125	75	50
@ $3/Gallon	$750	$375	$225	$150
@ $4/Gallon	$1,000	$500	$300	$200
@ $5/Gallon	$1,250	$625	$375	$250

As shown in the graph above, there is more annual savings when advancing from 20 to 30 mpg at $3 a gallon than there would be going from 30 to 40 mpg at $5 a gallon. In fact, the annual savings from 20 to 30 mpg at $3 a gallon is three times as great as it is from 50 to 60 mpg at $5 a gallon. When improving from 30 to 40 mpg at $4 a gallon, a consumer would save $500 annually. In order to achieve that same level of savings when improving from 50 to 60 mpg, gasoline would have to rise to $10 a gallon!

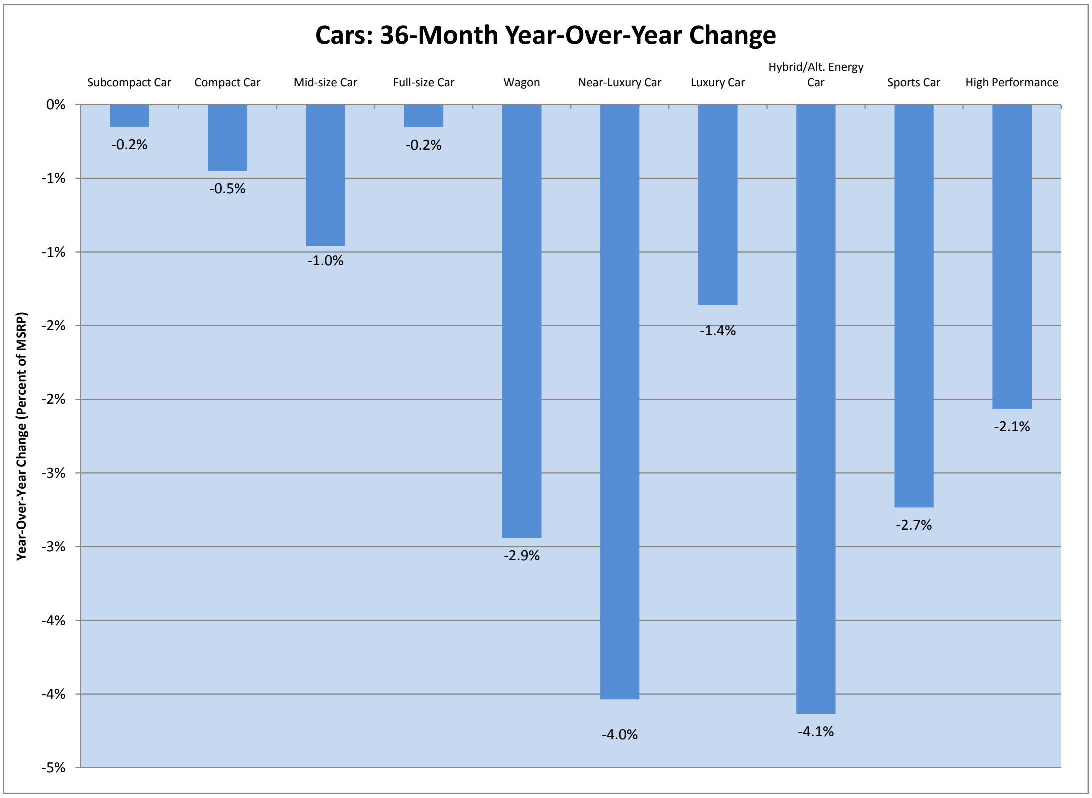
The point of this mathematical exercise is to demonstrate that CAFE standards and gasoline prices are inextricably related. From 2008, we know that consumers will trade for a more fuel-efficient vehicle when gas prices rise sufficiently high that it becomes economically necessary. As vehicles get more fuel efficient, it gets increasingly more difficult to generate sufficient savings unless gas prices rise as well. The current Kelley Blue Book® Residual Value forecast incorporates an assumption of fairly moderate fuel price increases for the coming five years.

To legislate CAFE requirements without a plan for gas prices could be asking for trouble. Should manufacturers build fuel-efficient vehicles at a higher cost without sufficiently high fuel prices, consumers are not likely to find them attractive. In that scenario, either sales volumes drop or residual values will be weak. Regardless, manufacturers' bottom lines likely will be hurt. To prevent this from happening, lawmakers need to be cautious to avoid legislation that defies basic economic principles.

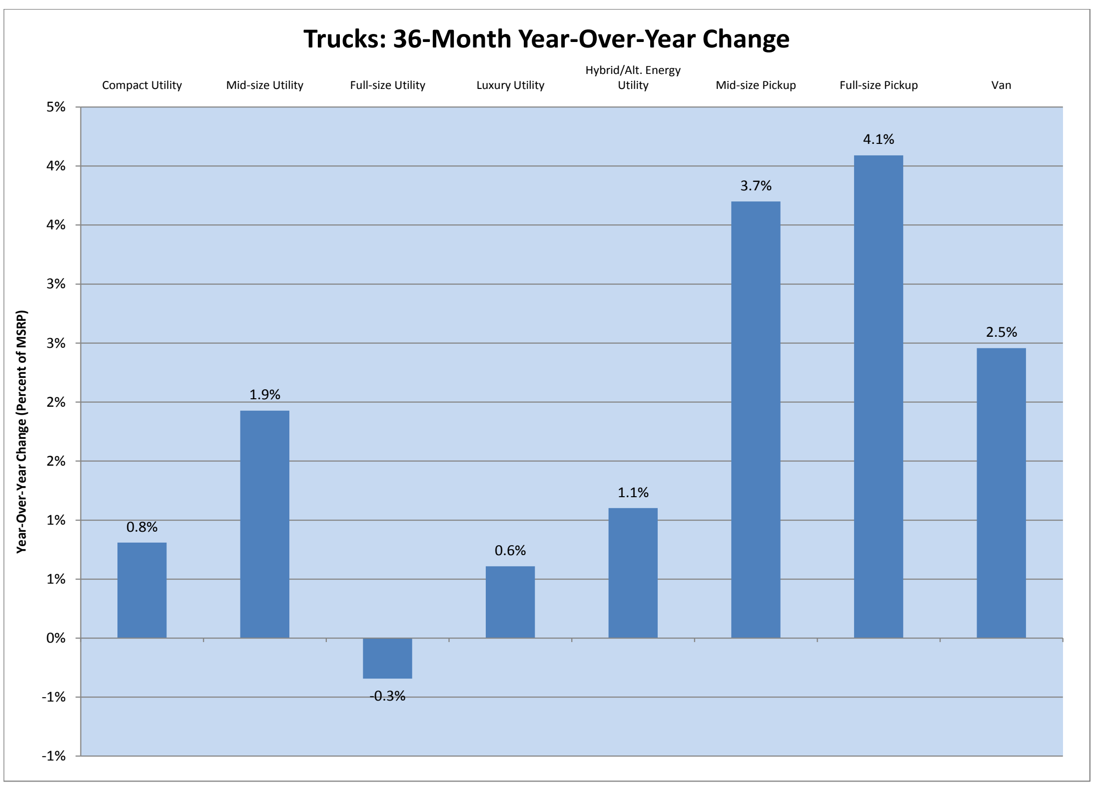
> ***"TO LEGISLATE CAFE REQUIREMENTS WITHOUT A PLAN FOR GAS PRICES COULD BE ASKING FOR TROUBLE."***
>
> ***-ERIC IBARA***

Truck Segment Strength, Weak Car Segment Keep Overall Residual Values Flat

Overall, the average 36-month residual value for all vehicles across the industry is nearly flat from a year ago, increasing only 0.5 percentage points (based on MSRP). However, the difference in all car and truck segments is dramatically evident. All car segments declined year-over-year, while all but one truck segment rose in value. The average drop across all cars was 1.7 percentage points, while the average increase for trucks was 2.3 percentage points. (Note: Kelley Blue Book Residual Value averages by segment are not sales weighted).



Hybrid/cars and near-luxury cars were most heavily impacted. The drop in the hybrid/alternative energy segment was due to major declines in the Toyota Prius, Honda Insight and Volkswagen Golf TDI. The near-luxury segment experienced a large decline with the BMW 1 Series and Volvo C70.



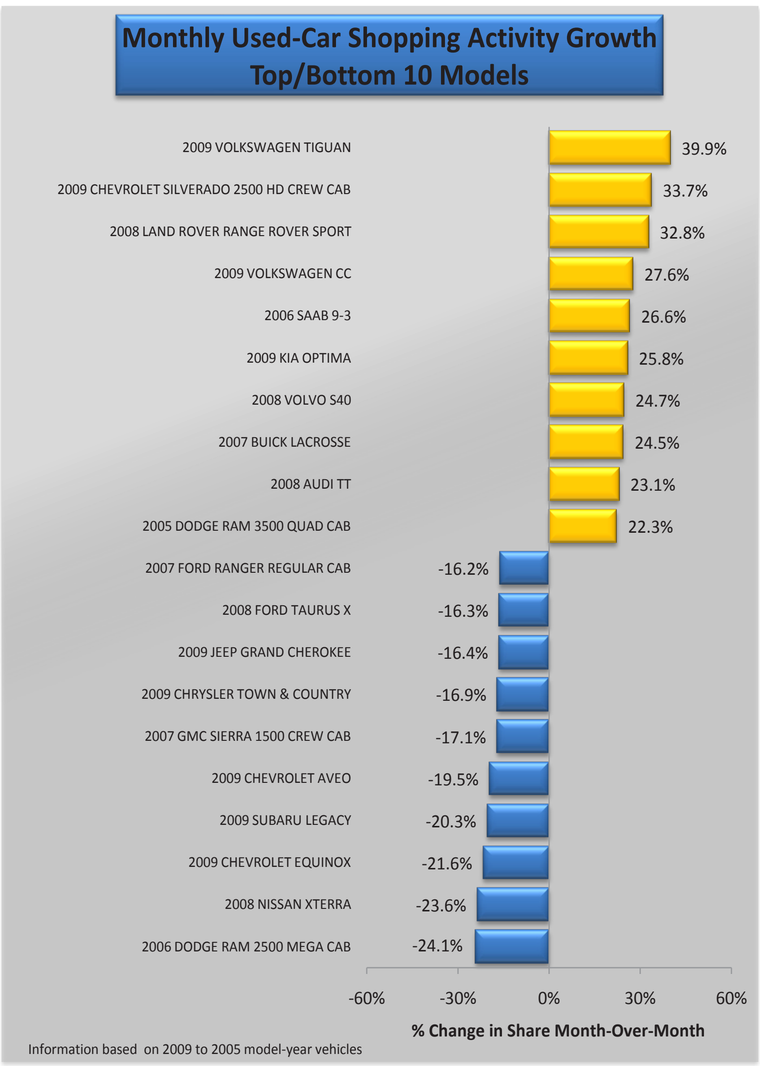
In the truck segments, the gains were led by the full-size and mid-size pickup segments. In the full-size segment, increases occurred primarily in the heavy-duty trucks (Ram Heavy Duty, GMC Sierra Heavy Duty/Chevrolet Silverado Heavy Duty and Ford F-Series Super Duty), and with the Nissan Titan. The mid-size truck segment strengthened with help from the Chevrolet Colorado/GMC Canyon and Suzuki Equator.

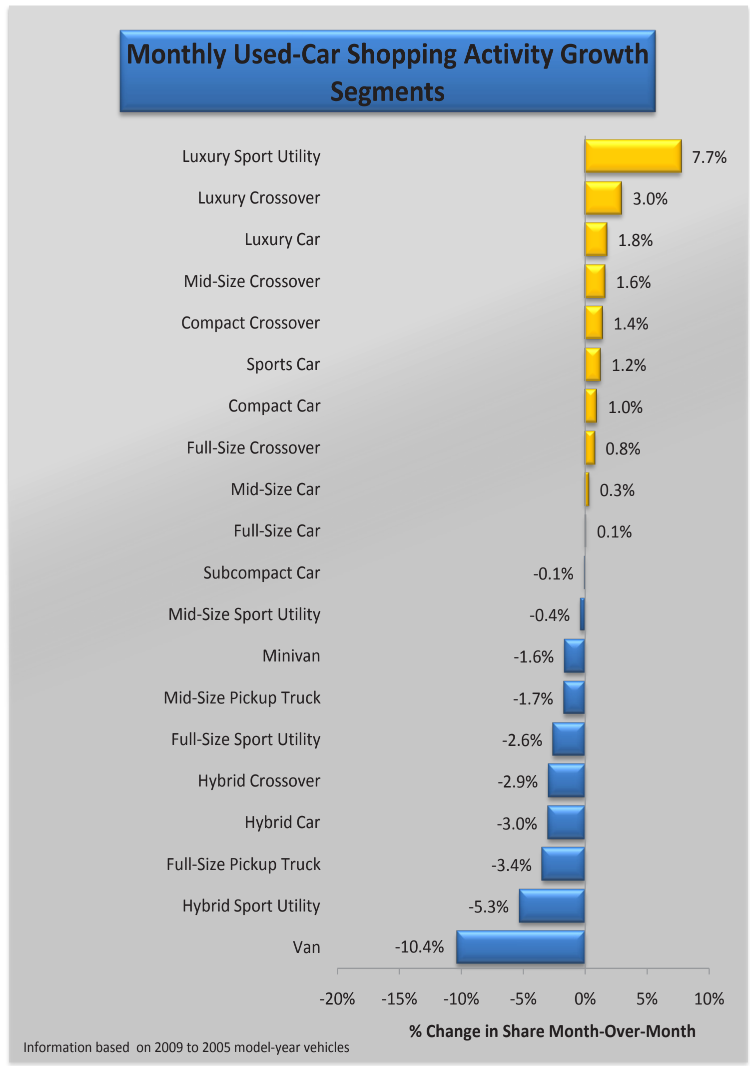
Luxury Sport Utility, Luxury Crossovers Gain Interest as Gas Prices Decline

Kelley Blue Book's Hot Used-Car Report captures monthly used-car shopper activity on kbb.com, including a list of the top and bottom movers in the same time period. Results are provided by the Kelley Blue Book Market Intelligence Team, in an effort to help dealers better understand which used vehicles consumers are looking at most each month.

Used-car shopper interest in hybrid vehicles declined in May, as a result of stabilizing gas prices and low used-car volumes. This is evident with the hybrid sport utility and hybrid car segments sinking in month-over-month traffic share by 5.3 percent and 3.0 percent, respectively.

The segments that have experienced a significant increase in traffic share are the luxury sport utility and luxury crossover segments. As gas prices start to decline, used intenders are now re-considering luxury vehicles. Dealers should look forward to off-loading their luxury inventory in the next couple of months as interest in these vehicles continue to rise.





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