

Improving Canadian Auto Loan Market Fundamentals

- Global sales accelerate further.
- Subprime auto loans decline in Canada, but lending to higher credit scores picks up.
- Canadian subprime loans account for roughly half the US share.
- Delinquencies are virtually non-existent outside of subprime clients.

RECENT GLOBAL NEW VEHICLE SALES DEVELOPMENTS

Global car sales accelerated through the summer, with volumes advancing 4.5% above a year earlier in August, double the growth of the previous three months. South America is leading the way, with a 14% year-to-date gain, including a 21% y/y surge in August. However, purchases have picked up in most regions. Volumes in Asia advanced at the fastest pace in six months, as sales in China hit the highest selling-rate in almost a year. Inventories have also fallen to multi-year lows, pointing to stronger vehicle output.

Sales continue to strengthen in Western Europe, buoyed by improving economic conditions and the strongest consumer confidence in more than fifteen years. Meanwhile, purchases in Eastern Europe have advanced 10% year-to-date, the best performance since the opening months of 2012; gains are broadly-based, with four countries reporting advances of more than 20% y/y in August. Volumes are back on the upswing in Russia, the region's largest market, with double-digit year-over-year sales gains in the last four months. The upturn reflects strengthening income gains and represents a sharp reversal from the cumulative slump of more than 50% in the Russian auto market during the previous four years.

More recent data for September point to a further strengthening in demand across North America. Sales in the NAFTA region picked up to 4.9% y/y last month, the best performance since last November. **Canada** led the way, with volumes advancing 8% y/y and setting a monthly record for September. However, the **US** was the big surprise in September, with volumes surging to an annualized 18.5 mn units, the highest since July 2005, and significantly above the average of 16.9 mn during the previous eight months. The rebound was aided by Texans replacing vehicles damaged by Hurricane Harvey. Car sales in Houston jumped 22% above a year earlier last month, rebounding from a 46% y/y plunge in August. The Houston area accounted for 6% of overall US sales in September, triple its normal share.

In Canada, the western provinces continue to lead the advance in new vehicle sales. Preliminary September volumes point to a fifth consecutive month of double-digit year-over-year gains. **This stronger-than-expected performance has led us to increase our full-year 2017 sales forecast to 2.03 mn units.**

AUTO LENDING DECELERATES

The Canadian and US auto loan markets have experienced rapid growth in recent years, raising concern among some analysts and credit rating agencies, especially since media headlines began highlighting the increase

CONTACTS

Carlos Gomes
416.866.4735
Scotiabank Economics
carlos.gomes@scotiabank.com

Chart 1

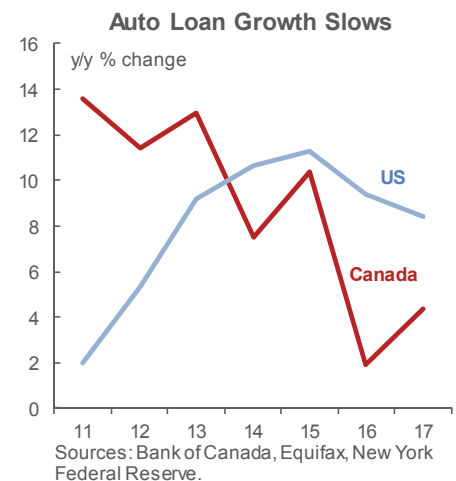
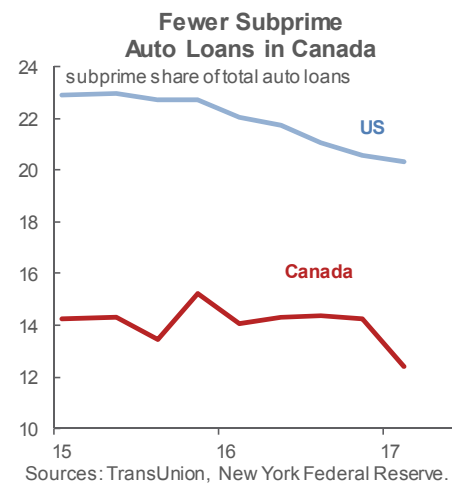


Chart 2



in default rates in the United States. However, we point out below that these risks are overstated, especially in Canada, where subprime auto loans represent a small and declining share of overall household loans.

Automotive lending expanded at a double-digit pace in both Canada and the United States during much of the current economic expansion, as credit availability improved following the global economic downturn of a decade ago. Year-over-year growth in auto loans peaked in Canada at more than 15% y/y in the first half of 2015, nearly double the advance in other types of household credit facilities. However, the pace of auto loan growth has since moderated to single-digits in both countries (chart 1).

The slowing in auto loan growth is especially evident in Canada, with lending for new vehicles advancing only 4.6% y/y in the second quarter of 2017, a percentage point lower than overall household credit growth. This reverses the sharp outperformance from early 2010 through mid-2015. In fact, **auto loan growth in Canada is now even lagging disposable income growth, highlighting the improving fundamentals in the Canadian auto loan market.** This also represents a sharp divergence from developments in the US where, despite some recent moderation in auto loan growth, autos remain the fastest-growing component of US consumer credit. According to the New York Federal Reserve, US auto loan growth was still nearly 8% y/y in mid-2017, outpacing overall household credit growth of 4.5%.

Canadian vehicle sales continue to climb to record highs, but much of the growth has recently shifted to leasing, prompting a moderation in auto loan growth. Leasing has improved vehicle affordability, by reducing the monthly payments required to drive a new car or light truck. Data from DesRosiers Automotive Consultants indicate that leasing now garners more than one-third of the Canadian retail new vehicle market, up from 19% four years ago and only 7% in 2009 during the global financial crisis. The rising popularity of leasing has driven the share of auto loans to less than 60% of the Canadian new vehicle market, the lowest level of the past decade and down from more than 68% in 2010.

FEW SUBPRIME AUTO LOANS IN CANADA

The slowdown in Canadian auto lending is taking place at the lower end of the credit spectrum—among subprime customers. In contrast, loans to more creditworthy clients continue to gain momentum, pointing to an improving credit profile. Data from TransUnion indicate that subprime auto loans declined 7% below a year earlier in the second quarter, a sharp reversal from nearly 5% y/y growth in late-2016. Meanwhile, loans to customers with a low delinquency history have accelerated to nearly triple the pace of a year ago. As a result, we **estimate that subprime loans now represent only 12% of the Canadian auto market, compared with 21% in the US (chart 2).** Auto loans also have a lower delinquency rate in Canada than other credit products.

INTERNATIONAL CAR SALES OUTLOOK

(millions of units)

	<u>1990–99</u>	<u>2000–13</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017f</u>
TOTAL SALES	39.20	53.74	71.18	72.61	77.29	79.58
North America*	16.36	17.74	19.42	20.64	21.05	20.75
Canada	1.27	1.61	1.85	1.90	1.95	2.03
United States	14.55	15.15	16.44	17.39	17.50	17.10
Mexico	0.54	0.98	1.13	1.35	1.60	1.62
Western Europe	13.11	13.79	12.11	13.20	13.97	14.39
Germany	3.57	3.25	3.04	3.21	3.35	3.47
Eastern Europe	1.18	3.03	3.81	3.15	3.14	3.39
Russia	0.78	1.83	2.49	1.60	1.43	1.55
Asia	6.91	16.08	31.69	32.29	36.06	37.58
China**	0.43	6.52	18.37	20.01	23.57	24.28
India	0.31	1.18	1.87	2.06	2.09	2.23
South America	1.64	3.10	4.15	3.33	3.07	3.47
Brazil	0.94	1.90	2.50	1.82	1.39	1.53

*Includes light trucks. **Includes crossover utility vehicles from 2005. Sources: Scotiabank Economics, Ward's Automotive Reports, Bloomberg.

CANADA/US MOTOR VEHICLE SALES OUTLOOK

	<u>1991-05</u>	<u>2006-14</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	
	Average				Jan-Aug **	Annual f
(thousands of units, annualized)						
CANADA	1,398	1,643	1,898	1,949	2,045	2,030
Cars	797	783	714	662	658	650
Domestic	583	491	476	438	468	460
Imports	214	292	238	224	190	190
Light Trucks	601	860	1,184	1,287	1,387	1,380
(millions of units, annualized)						
UNITED STATES	15.5	14.1	17.4	17.5	17.0	17.1
Cars	8.3	6.9	7.5	6.9	6.1	6.1
Light Trucks	7.2	7.2	9.9	10.6	10.9	11.0
(millions of units, annualized)						
NORTH AMERICAN PRODUCTION*	15.58	14.25	17.95	18.17	17.45	17.50
CANADA	2.50	2.24	2.28	2.37	2.26	2.30
UNITED STATES	11.67	9.53	12.10	12.20	11.21	11.30
MEXICO	1.41	2.48	3.57	3.60	3.98	3.90

*Includes light, medium and heavy trucks. **Canadian sales are Scotiabank estimates. Sources: Ward's Automotive Reports, Statistics Canada.

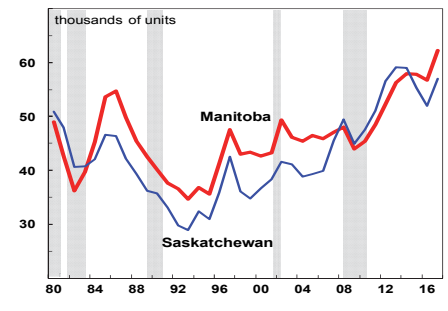
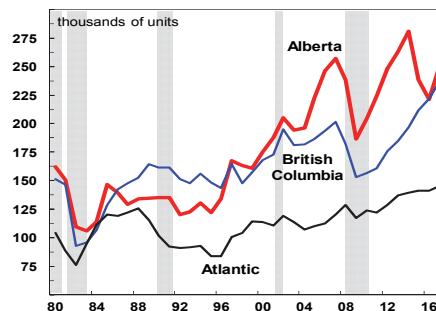
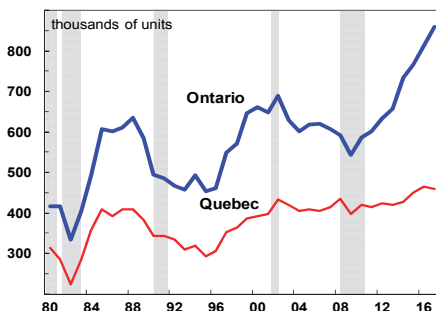
VEHICLE SALES OUTLOOK BY PROVINCE*

(thousands of units, annual rates)

	<u>1994-05</u>	<u>2006-14</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	
	Average				Jan-Aug**	Annual f
CANADA	1,446	1,643	1,898	1,949	2,045	2,030
ATLANTIC	102	123	140	140	145	142
CENTRAL	936	1,017	1,205	1,265	1,300	1,295
Quebec	366	411	444	458	452	450
Ontario	570	606	761	807	848	845
WEST	408	503	553	544	600	593
Manitoba	42	48	56	55	60	60
Saskatchewan	36	49	54	51	57	55
Alberta	166	231	236	220	248	248
British Columbia	164	175	207	218	235	230

*Includes cars and light trucks. **Scotiabank estimates. Sources: Statistics Canada, Canadian Vehicle Manufacturers' Association.

VEHICLE SALES BY PROVINCE



Includes cars and trucks (light, medium and heavy). Shaded bars indicate U.S. recession periods. Source: Statistics Canada.

AUTO MARKET SHARE BY MANUFACTURER — CANADA*

(thousands of units, not seasonally adjusted)

	<u>2016</u>		<u>2017</u>		<u>2016</u>		<u>2017</u>	
	Jan to Sept		Jan to Sept		Sept		Sept	
	Units	% of Total	Units	% of Total	Units	% of Total	Units	% of Total
TOTAL	522.3	100.0	516.0	100.0	58.2	100.0	60.3	100.0
Big Three	107.6	20.6	101.4	19.6	12.3	21.0	12.5	20.7
General Motors	53.4	10.2	54.1	10.5	7.8	13.4	8.6	14.2
Ford	37.3	7.2	31.7	6.1	3.5	6.0	3.2	5.4
Chrysler	16.9	3.2	15.6	3.0	1.0	1.6	0.7	1.1
Japanese	227.4	43.5	232.2	45.0	25.3	43.5	26.0	43.2
Honda	72.3	13.8	76.7	14.9	8.8	15.1	8.5	14.1
Toyota	71.5	13.7	70.5	13.7	7.8	13.5	8.7	14.4
Nissan	39.0	7.5	36.8	7.1	3.9	6.8	3.7	6.2
Mazda	24.9	4.8	27.1	5.2	2.6	4.5	2.8	4.7
Mitsubishi	7.7	1.5	6.6	1.3	0.7	1.3	0.7	1.1
Subaru	12.0	2.3	14.5	2.8	1.4	2.4	1.6	2.7
Hyundai	67.2	12.9	57.1	11.1	7.0	12.0	6.2	10.3
Volkswagen	38.1	7.3	39.3	7.6	4.0	6.8	4.4	7.3
Kia	31.5	6.0	31.8	6.2	3.5	6.0	4.9	8.1
BMW	17.9	3.4	17.3	3.3	2.2	3.9	2.2	3.7
Mercedes-Benz	17.6	3.4	18.0	3.5	2.3	4.0	2.0	3.3
Other	15.0	2.9	18.9	3.7	1.6	2.8	2.1	3.4

*Source: Dealer sales from the Global Automakers of Canada.

TRUCK MARKET SHARE BY MANUFACTURER — CANADA*

(thousands of units, not seasonally adjusted)

	<u>2016</u>		<u>2017</u>		<u>2016</u>		<u>2017</u>	
	Jan to Sept		Jan to Sept		Sept		Sept	
	Units	% of Total	Units	% of Total	Units	% of Total	Units	% of Total
TOTAL	1,008.5	100.0	1,098.2	100.0	118.2	100.0	129.5	100.0
Big Three	550.9	54.6	590.4	53.8	63.1	53.4	64.1	49.5
General Motors	146.1	14.5	178.4	16.3	17.7	15.0	18.6	14.4
Ford	201.5	20.0	214.5	19.5	26.7	22.6	27.7	21.4
Chrysler	203.3	20.1	197.5	18.0	18.7	15.8	17.8	13.7
Other Domestic	28.7	2.8	33.0	3.0	3.8	3.3	4.2	3.2
Japanese	286.0	28.4	316.6	28.8	34.7	29.3	40.3	31.1
Honda	69.5	6.9	77.9	7.1	8.8	7.5	9.7	7.5
Toyota	98.0	9.7	104.8	9.5	11.4	9.7	13.3	10.3
Nissan	65.3	6.5	77.5	7.1	7.8	6.6	9.7	7.5
Mazda	27.9	2.8	29.9	2.7	3.4	2.8	4.0	3.1
Mitsubishi	9.4	0.9	10.9	1.0	1.2	1.1	1.4	1.1
Subaru	25.3	2.5	26.5	2.4	3.2	2.7	3.5	2.7
Hyundai	45.1	4.5	46.4	4.2	4.7	3.9	5.8	4.5
Kia	24.5	2.4	28.0	2.6	3.0	2.6	2.9	2.2
Other Imports	73.3	7.3	83.8	7.6	8.9	7.5	12.2	9.5
LIGHT TRUCKS	986.1	97.8	1,074.7	97.9	115.3	97.5	126.4	97.6

*Source: Dealer sales from the Global Automakers of Canada.

AUTO SALES BY PROVINCE

(thousands of units, not seasonally adjusted)

	<u>2016</u> Jan to Aug	<u>2017</u> Jan to Aug	<u>2016</u> Aug	<u>2017</u> Aug
CANADA	464.0	458.2	58.6	60.9
ATLANTIC	34.0	33.3	4.0	4.7
Newfoundland	7.0	6.6	0.7	0.8
Nova Scotia	14.2	15.1	1.6	2.3
New Brunswick	10.5	9.5	1.4	1.3
Prince Edward Island	2.3	2.1	0.3	0.3
CENTRAL	328.7	325.0	42.6	43.4
Quebec	141.4	132.7	17.8	18.7
Ontario	187.3	192.3	24.8	24.7
WEST	101.3	99.9	12.0	12.8
Manitoba	10.1	9.7	1.3	1.2
Saskatchewan	6.4	6.2	0.8	0.8
Alberta	33.2	33.4	3.7	4.4
British Columbia	51.6	50.6	6.2	6.4

Source: Statistics Canada.

TRUCK SALES BY PROVINCE*

(thousands of units, not seasonally adjusted)

	<u>2016</u> Jan to Aug	<u>2017</u> Jan to Aug	<u>2016</u> Aug	<u>2017</u> Aug
CANADA	893.5	961.7	116.3	125.3
ATLANTIC	65.0	68.2	8.3	9.2
Newfoundland	16.5	16.9	2.1	2.3
Nova Scotia	23.4	26.5	3.0	3.4
New Brunswick	21.3	20.9	2.7	2.9
Prince Edward Island	3.8	3.9	0.5	0.6
CENTRAL	555.6	580.1	72.2	74.4
Quebec	180.7	184.5	23.0	24.4
Ontario	374.9	395.6	49.2	50.0
WEST	272.9	313.4	35.8	41.7
Manitoba	28.5	32.5	4.0	4.7
Saskatchewan	28.2	32.2	3.8	4.3
Alberta	117.0	136.9	15.0	18.0
British Columbia	99.2	111.8	13.0	14.7

*Light, medium and heavy trucks. Source: Statistics Canada.

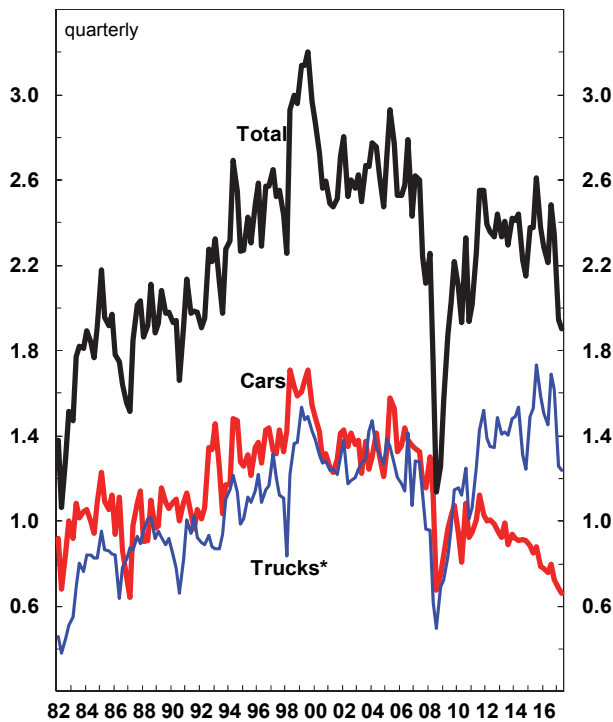
CANADIAN MOTOR VEHICLE PRODUCTION

(thousands of units, not seasonally adjusted)

	<u>2016</u>	<u>2017</u>	<u>2016</u>	<u>2017</u>
	Jan to Sept	Jan to Sept	Sept	Sept
TOTAL	1,801.1	1,691.2	204.7	162.7
CAR	611.4	561.4	71.2	63.1
Chrysler	182.0	168.4	20.7	20.1
GM	91.4	70.1	10.9	8.5
Honda	156.4	158.4	19.1	18.3
Toyota	181.6	164.5	20.5	16.2
TRUCKS*	1,189.7	1,129.8	133.5	99.6
Chrysler	236.5	231.1	26.5	20.7
Ford	208.0	192.1	22.1	18.6
GM	300.4	248.8	34.1	9.2
Honda	159.4	169.1	18.0	19.3
Toyota	273.8	274.1	31.5	29.6
Others	11.6	14.6	1.3	2.2

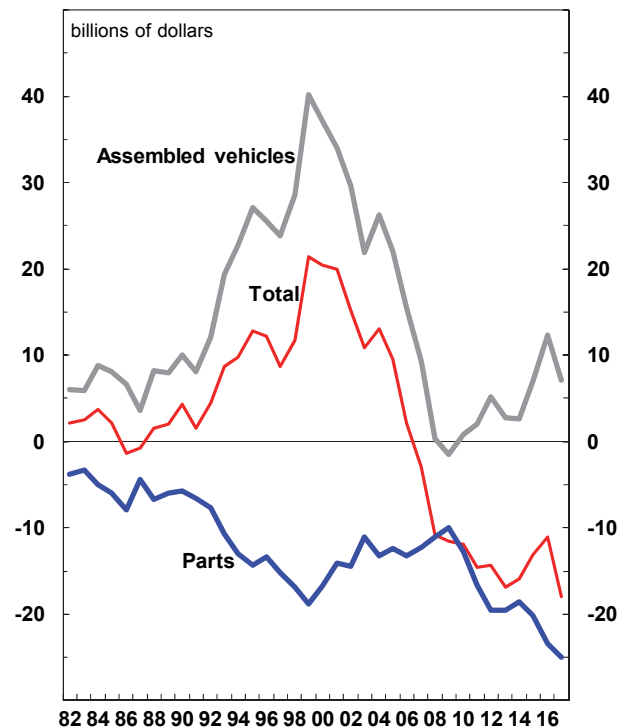
*Light, medium and heavy trucks. Source: Ward's Automotive Reports.

Canada — Motor Vehicle Production



Millions of units, seasonally adjusted annual rates.
*Light, medium and heavy trucks.
Source: Ward's Automotive Reports.

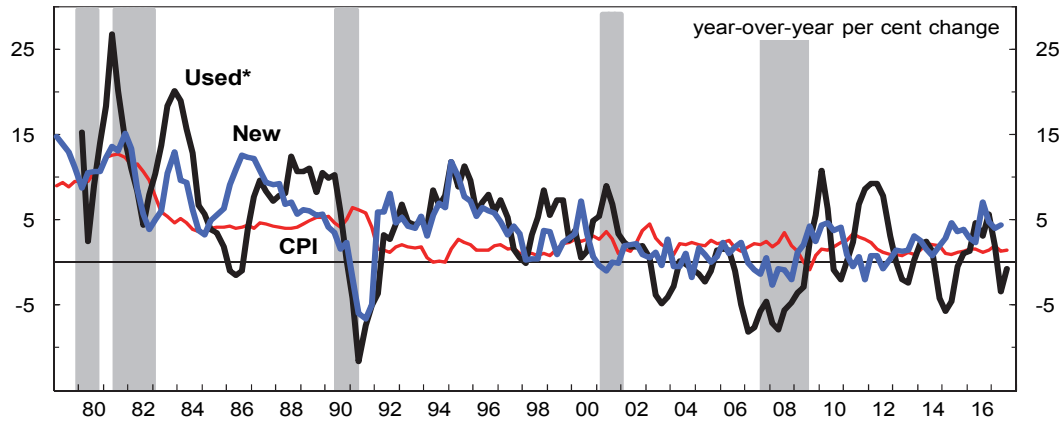
Canada — World Auto Trade Balances



2017 data are January-August annualized.
Source: Statistics Canada.

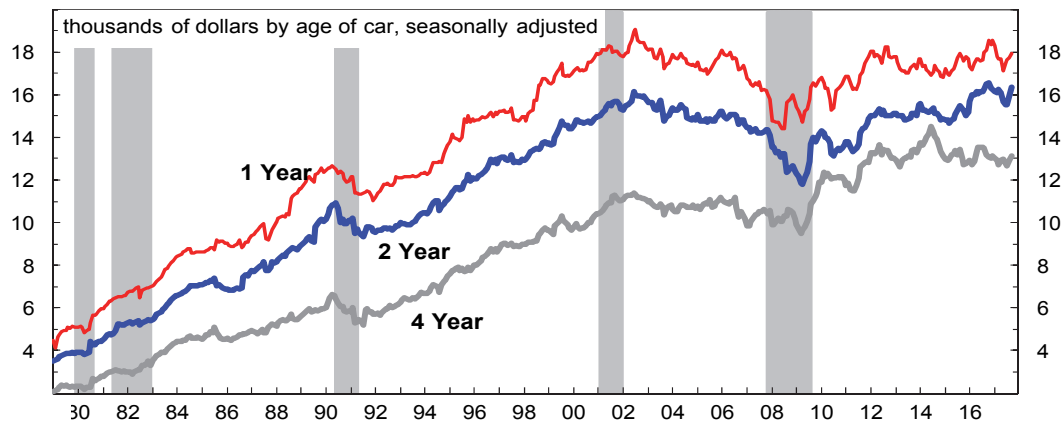
New & Used Car Prices

Scotiabank Car Price Indicators — Canada



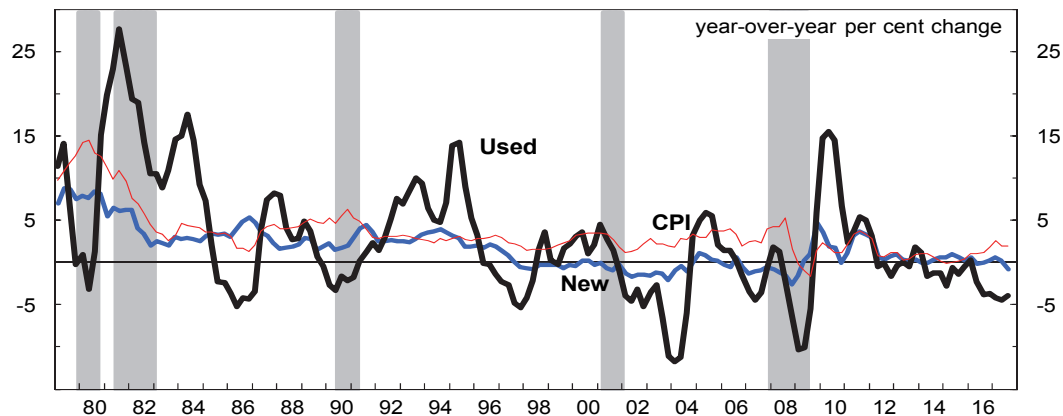
*Scotiabank estimate from Canadian Black Book data.
Sources: Canadian Black Book, Statistics Canada.

Scotiabank Car Price Indicators — Canada



Scotiabank estimate from Canadian Black Book data.

Scotiabank Car Price Indicators — United States



Consumer price indices for new and used cars.
Shaded areas indicate recession periods. Source: U.S Bureau of Labor Statistics.

CANADIAN CORPORATE FINANCIAL PERFORMANCE
MOTOR VEHICLE DEALERS AND REPAIR SHOPS

		Net Income After Tax (\$ mil)	Pre-Tax Profit Margin (%)	Inventory Turnover Ratio	Interest Coverage Ratio	Debt/ Equity Ratio	Return on Shareholders Equity (%)
Annual	2004	571	0.69	4.98	2.25	3.17	10.49
	2005	799	0.93	5.35	2.55	2.74	12.90
	2006	942	1.20	5.16	2.64	2.75	14.37
	2007	1089	1.41	5.05	3.36	2.56	15.13
	2008	1142	1.43	5.04	3.51	2.44	14.66
	2009	1392	1.84	5.34	4.85	2.07	16.99
	2010	1649	2.06	4.91	5.34	2.11	18.09
	2011	1664	1.99	5.17	5.19	2.02	17.44
	2012	1748	1.97	4.86	5.32	2.03	16.71
	2013	2215	2.32	5.08	6.64	2.02	20.08
	2014	2714	2.60	5.09	7.41	1.90	21.03
	2015	2929	2.63	5.16	7.54	1.93	21.31
2016	2963	2.40	5.03	7.70	1.96	20.02	
Quarterly at annual rates							
	2016Q2	3592	2.43	5.49	8.98	1.97	24.56
	Q3	3116	2.43	5.17	8.05	1.94	20.71
	Q4	2852	2.65	4.84	6.99	1.94	18.62
	2017Q1	2180	2.65	4.32	6.18	2.08	14.27
	Q2	3728	2.43	5.18	8.52	2.07	23.88
Average (89–16)		930	1.32	6.04	3.38	2.34	12.09
Low (89–16)		-68	0.10	4.38	1.10	3.57	-1.20

Definition of Ratios:

Pre-tax Profit Margin: pre-tax income/sales

Inventory Turnover Ratio: sales/inventory

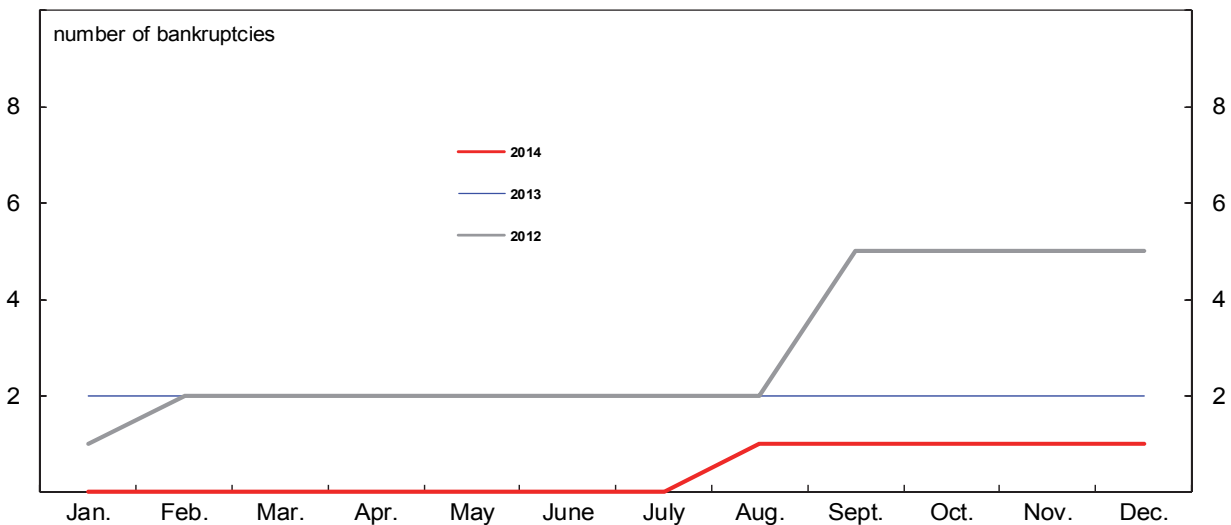
Source: Statistics Canada.

Interest Coverage Ratio: (pre-tax income and interest payments)/(interest payments)

Debt/Equity Ratio: (short-term and long-term debt)/total equity

Return of Shareholders' Equity: after-tax income/total equity

Retail Auto Dealer Bankruptcies



New car dealers only; cumulative total during the year.
Source: Office of the Superintendent of Bankruptcy.

This report has been prepared by Scotiabank Economics as a resource for the clients of Scotiabank. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Scotiabank nor any of its officers, directors, partners, employees or affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.

These reports are provided to you for informational purposes only. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any financial instrument, nor shall this report be construed as an opinion as to whether you should enter into any swap or trading strategy involving a swap or any other transaction. The information contained in this report is not intended to be, and does not constitute, a recommendation of a swap or trading strategy involving a swap within the meaning of U.S. Commodity Futures Trading Commission Regulation 23.434 and Appendix A thereto. This material is not intended to be individually tailored to your needs or characteristics and should not be viewed as a “call to action” or suggestion that you enter into a swap or trading strategy involving a swap or any other transaction. Scotiabank may engage in transactions in a manner inconsistent with the views discussed this report and may have positions, or be in the process of acquiring or disposing of positions, referred to in this report.

Scotiabank, its affiliates and any of their respective officers, directors and employees may from time to time take positions in currencies, act as managers, co-managers or underwriters of a public offering or act as principals or agents, deal in, own or act as market makers or advisors, brokers or commercial and/or investment bankers in relation to securities or related derivatives. As a result of these actions, Scotiabank may receive remuneration. All Scotiabank products and services are subject to the terms of applicable agreements and local regulations. Officers, directors and employees of Scotiabank and its affiliates may serve as directors of corporations.

Any securities discussed in this report may not be suitable for all investors. Scotiabank recommends that investors independently evaluate any issuer and security discussed in this report, and consult with any advisors they deem necessary prior to making any investment.

This report and all information, opinions and conclusions contained in it are protected by copyright. This information may not be reproduced without the prior express written consent of Scotiabank.

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable.

Scotiabank, together with “Global Banking and Markets”, is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including, Scotiabanc Inc.; Citadel Hill Advisors L.L.C.; The Bank of Nova Scotia Trust Company of New York; Scotiabank Europe plc; Scotiabank (Ireland) Limited; Scotiabank Inverlat S.A., Institución de Banca Múltiple, Scotia Inverlat Casa de Bolsa S.A. de C.V., Scotia Inverlat Derivados S.A. de C.V. – all members of the Scotiabank group and authorized users of the Scotiabank mark. The Bank of Nova Scotia is incorporated in Canada with limited liability and is authorised and regulated by the Office of the Superintendent of Financial Institutions Canada. The Bank of Nova Scotia is authorised by the UK Prudential Regulation Authority and is subject to regulation by the UK Financial Conduct Authority and limited regulation by the UK Prudential Regulation Authority. Details about the extent of The Bank of Nova Scotia's regulation by the UK Prudential Regulation Authority are available from us on request. Scotiabank Europe plc is authorised by the UK Prudential Regulation Authority and regulated by the UK Financial Conduct Authority and the UK Prudential Regulation Authority.

Scotiabank Inverlat, S.A., Scotia Inverlat Casa de Bolsa, S.A. de C.V., and Scotia Derivados, S.A. de C.V., are each authorized and regulated by the Mexican financial authorities.

Not all products and services are offered in all jurisdictions. Services described are available in jurisdictions where permitted by law.