

Improving US Household and Business Fundamentals Point to Higher Sales Ahead

- Emerging markets drive global sales gains, amid temporary US weakness.
- US auto credit quality improves.
- US businesses accelerate fleet replacement, as rental industry demand begins to stabilize.

GLOBAL CAR SALES ACCELERATE IN EMERGING MARKETS

Global auto sales advanced 3% y/y in the first two months of 2018, accelerating from a 2.3% gain during all of 2017. The improvement is being led by double-digit gains in many emerging markets and reflects the strongest global economic growth since early 2014. In particular, purchases in Eastern Europe have surged 19% y/y so far this year, while volumes in South America have jumped 16% y/y.

Passenger vehicle sales in Canada have advanced 4% y/y through February, climbing to a record pace approaching an annualized 2.1 million units. The gains have been broadly-based, with volumes in Ontario powering ahead a further 5% y/y. This advance is in sharp contrast to slumping existing home sales, which have plunged 27% below a year earlier in Ontario, reducing overall volumes in Canada 11% y/y, and pulling the average Canadian home price below a year earlier for the first time in nearly a decade. Historically, Canadian auto sales and existing home purchases have tracked well together, with only temporary sharp divergences (chart 1). Given the ongoing strength in most economic indicators outside of existing home sales, we believe that the auto market provides a more accurate assessment of overall economic conditions across Canada.

Purchases also continue to gain momentum in Western Europe, advancing 4.5% y/y in the opening months of 2018, nearly double the 2.5% increase reported during all of 2017. The advance is being buoyed by the fastest economic expansion across Europe since the global economic crisis of a decade ago. Spain and Germany are leading the sales gains among the largest European auto markets this year, with year-over-year gains of 16% and 9.5% respectively.

US CONSUMER FUNDAMENTALS CONTINUE TO IMPROVE

The United States has been one of the few countries to report lower passenger vehicle sales so far this year. However, we remain confident that purchases should pick up as 2018 progresses, buoyed by strengthening economic activity and improving household incomes. In particular, US auto financing trends and vehicle pricing point to a healthy, not a deteriorating, auto market. Meanwhile, fleet volumes, the major source of weakness over the past year, are beginning to stabilize as businesses replace their aging fleets and the sharp decline from the rental-car industry moderates.

US households account for 85% of all US new vehicle sales and are benefitting from the lowest unemployment rate since the tech-boom of nearly twenty years ago. Income gains have accelerated in recent months and will be

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Chart 1

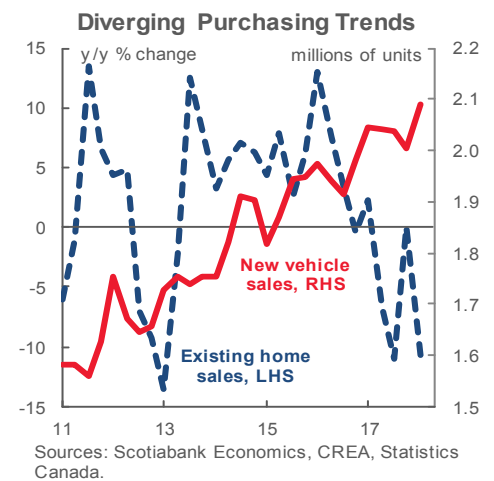
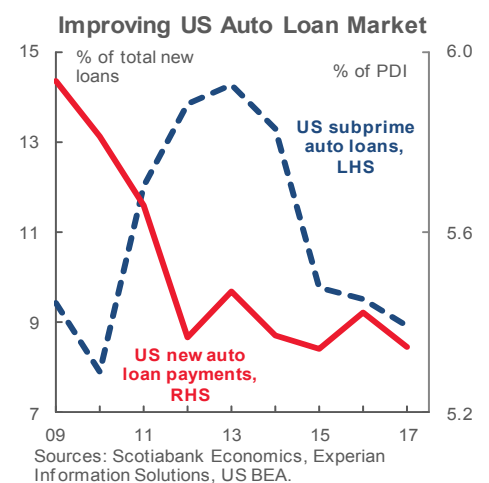


Chart 2



further buoyed by the US fiscal reform package which is expected to boost US GDP growth by an estimated 0.3 percentage points this year and next, while also lowering taxes for most households. In fact, data from the US Treasury Department indicate that personal tax collections have declined in the opening months of 2018, including a 26% y/y plunge in February, even as income and average hourly wage gains have accelerated. This leaves additional income in the pockets of US households at time when consumer confidence is at a 14-year high, and surveys indicate that a majority of households believe this is a good time to buy a new vehicle.

HIGH-QUALITY US AUTO LOANS GAIN MARKET SHARE

Data from Experian, a leading global information services company, indicate that the health of new automotive loans continues to improve in the United States, with prime and super-prime auto loans gaining market share alongside strengthening household finances. These two segments accounted for a record 74% of all new vehicle sales in late-2017, up from an average of 72.6% during the past three years. In contrast, the share of sub-prime auto loans has dropped to only 8.8%, down from a high of 10% in late-2015 (chart 2). The average credit score for auto loans and leases is also on the upswing, climbing to a four-year high in late-2017.

Highlighting the improving economic and financial backdrop, the number of delinquent US auto loans has also begun to turn down, reversing the upward trajectory that had been in place since mid-2016. According to Experian, both 30- and 60-day delinquencies declined roughly 3% below a year earlier in the final months of 2017, the largest year-over-year improvement in more than two years.

In addition, despite concerns that rising interest rates will lead to deteriorating vehicle affordability, monthly auto loan payments have increased by only USD 22 per month since US short-term interest rates bottomed in December 2015. **In fact, after adjusting for ongoing gains in disposable income, auto loans absorbed a near-record low of only 5.35% of household income in late-2017, in-line with the level prevailing in late-2015 (chart 2).** In contrast, when the US auto market peaked in the middle of the previous decade, auto loans absorbed more than 6% of household income.

RISING BUSINESS PURCHASES WILL OVERWHELM WEAK RENTAL VOLUMES

The rental-car industry was the main source of weakness in the US auto market last year, with purchases dropping 12% to 1.59 mn units. Volumes have declined an additional 3% y/y in the opening months of 2018, but impact on industry volumes is starting to be mitigated by businesses renewing their aging vehicle fleets. For example, while business volumes were flat last year, purchases have jumped 11.7% y/y in the opening months of 2018, and automakers report that ordering has strengthened even more. Excluding purchases by the rental-car industry, new US new vehicle sales were largely flat in 2017, and strengthening household and business fundamentals point to some improvement from current levels in coming months.

INTERNATIONAL CAR SALES OUTLOOK

(millions of units)

| | <u>1990–99</u> | <u>2000–14</u> | <u>2015</u> | <u>2016</u> | <u>2017</u> | <u>2018f</u> |
|-----------------------|----------------|----------------|--------------|--------------|--------------|--------------|
| TOTAL SALES | 39.20 | 54.89 | 72.61 | 77.25 | 79.02 | 81.57 |
| North America* | 16.36 | 17.85 | 20.64 | 21.01 | 20.70 | 20.93 |
| Canada | 1.27 | 1.62 | 1.90 | 1.95 | 2.04 | 2.00 |
| United States | 14.55 | 15.24 | 17.39 | 17.46 | 17.13 | 17.40 |
| Mexico | 0.54 | 0.99 | 1.35 | 1.60 | 1.53 | 1.53 |
| Western Europe | 13.11 | 13.67 | 13.20 | 13.97 | 14.32 | 14.54 |
| Germany | 3.57 | 3.23 | 3.21 | 3.35 | 3.44 | 3.49 |
| Eastern Europe | 1.18 | 3.08 | 3.15 | 3.14 | 3.41 | 3.54 |
| Russia | 0.78 | 1.87 | 1.60 | 1.43 | 1.60 | 1.68 |
| Asia | 6.91 | 17.12 | 32.29 | 36.06 | 37.10 | 38.79 |
| China** | 0.43 | 7.31 | 20.01 | 23.57 | 24.20 | 24.93 |
| India | 0.31 | 1.23 | 2.06 | 2.09 | 2.20 | 2.33 |
| South America | 1.64 | 3.17 | 3.33 | 3.07 | 3.49 | 3.77 |
| Brazil | 0.94 | 1.94 | 1.82 | 1.39 | 1.50 | 1.61 |

*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>2006-15</u> | <u>2016</u> | <u>2017</u> | <u>2018</u> | |
|-----------------------------------|----------------|----------------|--------------|--------------|--------------|--------------|
| | Average | | | | Jan ** | Annual f |
| (thousands of units, annualized) | | | | | | |
| CANADA | 1,398 | 1,668 | 1,949 | 2,041 | 2,089 | 2,000 |
| Cars | 797 | 776 | 662 | 644 | 627 | 610 |
| Domestic | 583 | 490 | 439 | 438 | 425 | 415 |
| Imports | 214 | 286 | 223 | 206 | 202 | 195 |
| Light Trucks | 601 | 892 | 1,287 | 1,397 | 1,462 | 1,390 |
| (millions of units, annualized) | | | | | | |
| UNITED STATES | 15.5 | 14.4 | 17.5 | 17.1 | 17.0 | 17.4 |
| Cars | 8.3 | 6.9 | 6.9 | 6.1 | 5.5 | 6.0 |
| Light Trucks | 7.2 | 7.5 | 10.6 | 11.0 | 11.5 | 11.4 |
| (millions of units, annualized) | | | | | | |
| NORTH AMERICAN PRODUCTION* | 15.58 | 14.63 | 18.15 | 17.48 | 17.52 | 17.76 |
| CANADA | 2.50 | 2.24 | 2.37 | 2.19 | 2.07 | 2.10 |
| UNITED STATES | 11.67 | 9.80 | 12.18 | 11.23 | 11.51 | 11.45 |
| MEXICO | 1.41 | 2.59 | 3.60 | 4.06 | 3.94 | 4.21 |

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

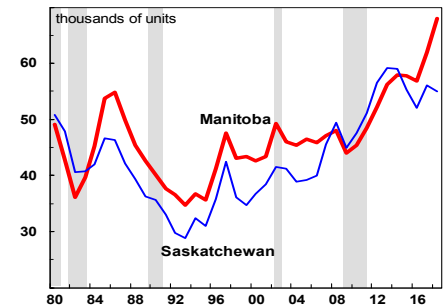
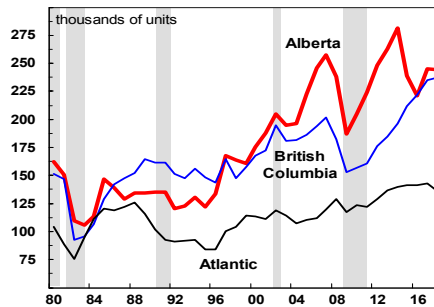
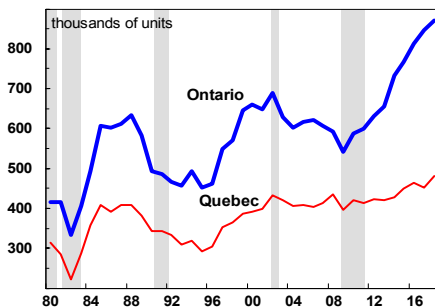
VEHICLE SALES OUTLOOK BY PROVINCE*

(thousands of units, annual rates)

| | <u>1994-05</u> | <u>2006-15</u> | <u>2016</u> | <u>2017</u> | <u>2018</u> | |
|------------------|----------------|----------------|--------------|--------------|--------------|--------------|
| | Average | | | | Jan ** | Annual f |
| CANADA | 1,446 | 1,668 | 1,949 | 2,041 | 2,089 | 2,000 |
| ATLANTIC | 102 | 125 | 140 | 143 | 136 | 138 |
| CENTRAL | 936 | 1,034 | 1,265 | 1,300 | 1,359 | 1,266 |
| Quebec | 366 | 411 | 458 | 453 | 479 | 445 |
| Ontario | 570 | 623 | 807 | 847 | 880 | 821 |
| WEST | 408 | 509 | 544 | 598 | 594 | 596 |
| Manitoba | 42 | 49 | 55 | 62 | 70 | 61 |
| Saskatchewan | 36 | 49 | 51 | 56 | 53 | 56 |
| Alberta | 166 | 232 | 220 | 245 | 241 | 248 |
| British Columbia | 164 | 179 | 218 | 235 | 230 | 231 |

*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>2017</u> | | <u>2018</u> | | <u>2017</u> | | <u>2018</u> | |
|----------------|-------------|--------------|-------------|--------------|-------------|--------------|-------------|--------------|
| | Jan to Feb | | Jan to Feb | | Feb | | Feb | |
| | Units | % of Total | Units | % of Total | Units | % of Total | Units | % of Total |
| TOTAL | 70.2 | 100.0 | 66.8 | 100.0 | 38.1 | 100.0 | 35.7 | 100.0 |
| Big Three | 13.8 | 19.7 | 13.3 | 19.9 | 7.2 | 18.8 | 7.4 | 20.7 |
| General Motors | 6.7 | 9.6 | 8.0 | 12.0 | 3.6 | 9.5 | 4.1 | 11.6 |
| Ford | 4.0 | 5.7 | 3.7 | 5.5 | 2.2 | 5.7 | 2.1 | 5.8 |
| Chrysler | 3.1 | 4.4 | 1.6 | 2.4 | 1.4 | 3.6 | 1.2 | 3.3 |
| Japanese | 31.9 | 45.4 | 31.2 | 46.7 | 17.4 | 45.8 | 16.0 | 44.8 |
| Honda | 9.6 | 13.7 | 11.3 | 16.9 | 5.2 | 13.7 | 5.3 | 14.8 |
| Toyota | 9.3 | 13.3 | 8.7 | 13.0 | 5.2 | 13.6 | 4.8 | 13.4 |
| Nissan | 6.0 | 8.5 | 5.3 | 8.0 | 3.3 | 8.6 | 2.9 | 8.0 |
| Mazda | 3.9 | 5.6 | 3.4 | 5.2 | 2.1 | 5.6 | 1.8 | 5.0 |
| Mitsubishi | 1.0 | 1.4 | 0.7 | 1.0 | 0.5 | 1.3 | 0.4 | 1.0 |
| Subaru | 2.1 | 2.9 | 1.7 | 2.6 | 1.1 | 2.9 | 0.9 | 2.5 |
| Hyundai | 7.2 | 10.3 | 6.1 | 9.2 | 4.1 | 10.9 | 3.5 | 9.8 |
| Volkswagen | 4.8 | 6.8 | 5.0 | 7.5 | 2.4 | 6.4 | 2.5 | 7.0 |
| Kia | 3.9 | 5.6 | 3.5 | 5.2 | 2.2 | 5.7 | 2.0 | 5.5 |
| BMW | 2.7 | 3.8 | 2.3 | 3.4 | 1.6 | 4.2 | 1.2 | 3.5 |
| Mercedes-Benz | 3.5 | 5.0 | 3.1 | 4.6 | 1.9 | 4.9 | 1.7 | 4.9 |
| Other | 2.4 | 3.4 | 2.3 | 3.5 | 1.3 | 3.3 | 1.4 | 3.8 |

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

TRUCK MARKET SHARE BY MANUFACTURER — CANADA*

(thousands of units, not seasonally adjusted)

| | <u>2017</u> | | <u>2018</u> | | <u>2017</u> | | <u>2018</u> | |
|----------------|--------------|--------------|--------------|--------------|-------------|--------------|-------------|--------------|
| | Jan to Feb | | Jan to Feb | | Feb | | Feb | |
| | Units | % of Total | Units | % of Total | Units | % of Total | Units | % of Total |
| TOTAL | 167.2 | 100.0 | 181.2 | 100.0 | 86.8 | 100.0 | 88.6 | 100.0 |
| Big Three | 91.1 | 54.4 | 93.0 | 51.3 | 47.5 | 54.7 | 45.0 | 50.9 |
| General Motors | 24.4 | 14.6 | 26.8 | 14.8 | 12.9 | 14.9 | 12.9 | 14.6 |
| Ford | 32.2 | 19.2 | 31.2 | 17.2 | 16.8 | 19.3 | 14.8 | 16.7 |
| Chrysler | 34.5 | 20.6 | 35.0 | 19.3 | 17.8 | 20.5 | 17.3 | 19.6 |
| Other Domestic | 5.2 | 3.1 | 6.9 | 3.8 | 2.7 | 3.2 | 3.3 | 3.7 |
| Japanese | 48.6 | 29.1 | 54.3 | 30.0 | 25.1 | 28.9 | 27.2 | 30.7 |
| Honda | 12.2 | 7.3 | 13.6 | 7.5 | 6.4 | 7.4 | 7.1 | 8.0 |
| Toyota | 16.3 | 9.7 | 17.0 | 9.4 | 8.2 | 9.5 | 8.6 | 9.7 |
| Nissan | 11.8 | 7.1 | 13.3 | 7.3 | 6.2 | 7.2 | 6.4 | 7.2 |
| Mazda | 4.6 | 2.8 | 5.6 | 3.1 | 2.4 | 2.7 | 2.8 | 3.1 |
| Mitsubishi | 1.6 | 0.9 | 2.2 | 1.2 | 0.8 | 0.9 | 0.9 | 1.0 |
| Subaru | 3.7 | 2.2 | 4.7 | 2.6 | 1.8 | 2.1 | 2.4 | 2.7 |
| Hyundai | 5.8 | 3.5 | 5.5 | 3.0 | 3.1 | 3.5 | 2.6 | 2.9 |
| Kia | 3.5 | 2.1 | 3.6 | 2.0 | 1.8 | 2.1 | 1.8 | 2.0 |
| Other Imports | 13.0 | 7.8 | 17.9 | 9.9 | 6.6 | 7.6 | 8.7 | 9.8 |
| LIGHT TRUCKS | 163.5 | 97.8 | 175.8 | 97.0 | 84.8 | 97.7 | 86.1 | 97.1 |

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

AUTO SALES BY PROVINCE

(thousands of units, not seasonally adjusted)

| | <u>2016</u> Jan to Dec | <u>2017</u> Jan to Dec | <u>2017</u> Jan | <u>2018</u> Jan |
|----------------------|---------------------------|---------------------------|--------------------|--------------------|
| CANADA | 661.1 | 646.9 | 32.1 | 32.8 |
| ATLANTIC | 47.1 | 45.6 | 1.9 | 1.9 |
| Newfoundland | 9.5 | 8.8 | 0.3 | 0.4 |
| Nova Scotia | 20.2 | 20.8 | 0.9 | 0.9 |
| New Brunswick | 14.3 | 13.2 | 0.6 | 0.5 |
| Prince Edward Island | 3.1 | 2.8 | 0.1 | 0.1 |
| CENTRAL | 467.6 | 461.3 | 22.0 | 22.3 |
| Quebec | 198.5 | 187.7 | 8.5 | 8.9 |
| Ontario | 269.1 | 273.6 | 13.5 | 13.4 |
| WEST | 146.4 | 140.0 | 8.2 | 8.6 |
| Manitoba | 14.4 | 13.6 | 0.6 | 0.9 |
| Saskatchewan | 9.3 | 8.7 | 0.5 | 0.6 |
| Alberta | 47.7 | 46.6 | 2.7 | 2.7 |
| British Columbia | 75.0 | 71.1 | 4.4 | 4.4 |

Source: Statistics Canada.

TRUCK SALES BY PROVINCE*

(thousands of units, not seasonally adjusted)

| | <u>2016</u> Jan to Dec | <u>2017</u> Jan to Dec | <u>2017</u> Jan | <u>2018</u> Jan |
|----------------------|---------------------------|---------------------------|--------------------|--------------------|
| CANADA | 1,317.5 | 1,417.4 | 80.1 | 86.8 |
| ATLANTIC | 94.4 | 98.4 | 5.0 | 4.9 |
| Newfoundland | 24.2 | 24.4 | 1.2 | 1.2 |
| Nova Scotia | 34.2 | 38.2 | 2.0 | 1.8 |
| New Brunswick | 30.3 | 30.1 | 1.5 | 1.6 |
| Prince Edward Island | 5.7 | 5.7 | 0.3 | 0.3 |
| CENTRAL | 814.5 | 853.6 | 46.7 | 50.2 |
| Quebec | 261.8 | 270.0 | 13.9 | 15.1 |
| Ontario | 552.7 | 583.6 | 32.8 | 35.1 |
| WEST | 408.6 | 465.4 | 28.4 | 31.7 |
| Manitoba | 43.1 | 49.7 | 2.8 | 4.6 |
| Saskatchewan | 42.8 | 47.5 | 3.0 | 2.8 |
| Alberta | 175.9 | 202.2 | 12.3 | 13.4 |
| British Columbia | 146.8 | 166.0 | 10.3 | 10.9 |

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

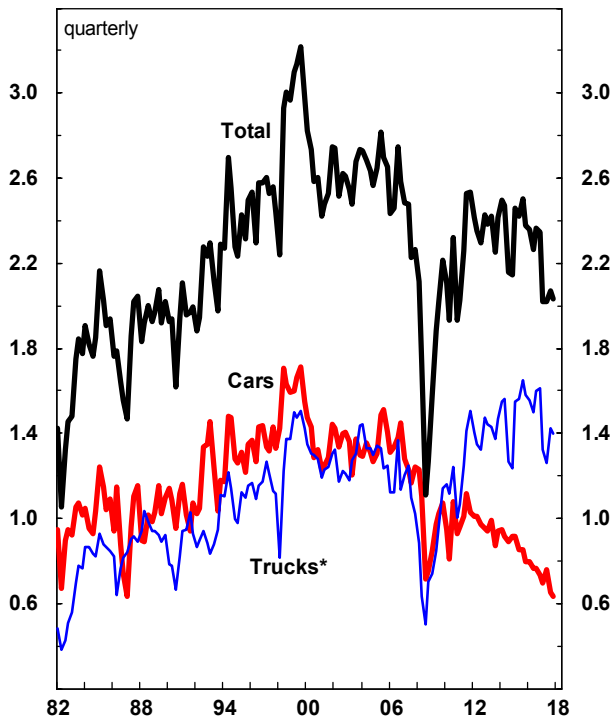
CANADIAN MOTOR VEHICLE PRODUCTION

(thousands of units, not seasonally adjusted)

| | <u>2017</u> | <u>2018</u> | <u>2017</u> | <u>2018</u> |
|----------------|--------------|--------------|--------------|--------------|
| | Jan to Feb | Jan to Feb | Feb | Feb |
| TOTAL | 380.3 | 346.9 | 169.4 | 177.5 |
| CAR | 123.7 | 109.3 | 50.1 | 59.2 |
| Chrysler | 34.3 | 32.2 | 10.5 | 21.7 |
| GM | 12.8 | 7.3 | 2.6 | 4.8 |
| Honda | 36.0 | 36.3 | 19.0 | 17.3 |
| Toyota | 40.6 | 33.5 | 18.0 | 15.4 |
| TRUCKS* | 256.6 | 237.6 | 119.3 | 118.3 |
| Chrysler | 48.0 | 56.3 | 23.8 | 32.4 |
| Ford | 42.9 | 46.4 | 24.3 | 22.2 |
| GM | 64.7 | 40.2 | 20.5 | 19.7 |
| Honda | 37.6 | 38.7 | 20.9 | 17.8 |
| Toyota | 61.2 | 53.2 | 28.4 | 24.8 |
| Others | 2.2 | 2.8 | 1.4 | 1.4 |

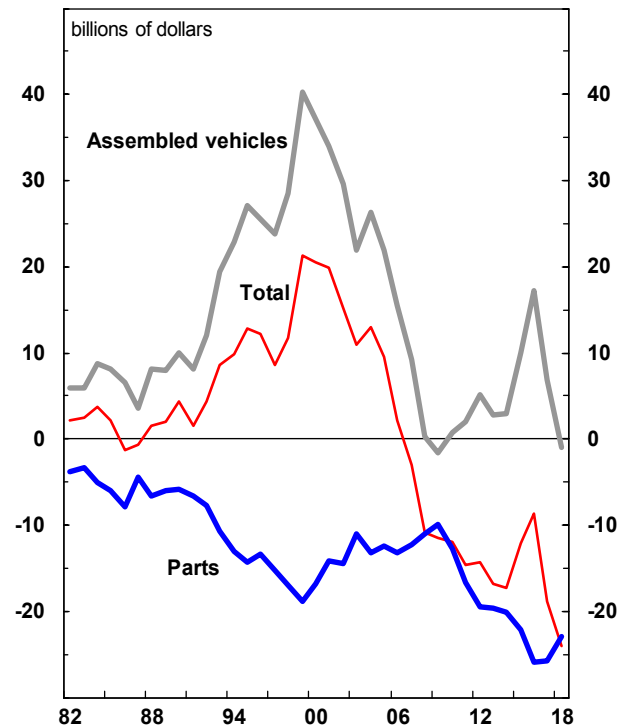
*Light, medium and heavy trucks. Source: Ward's Automotive Reports.

Canada — Motor Vehicle Production



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

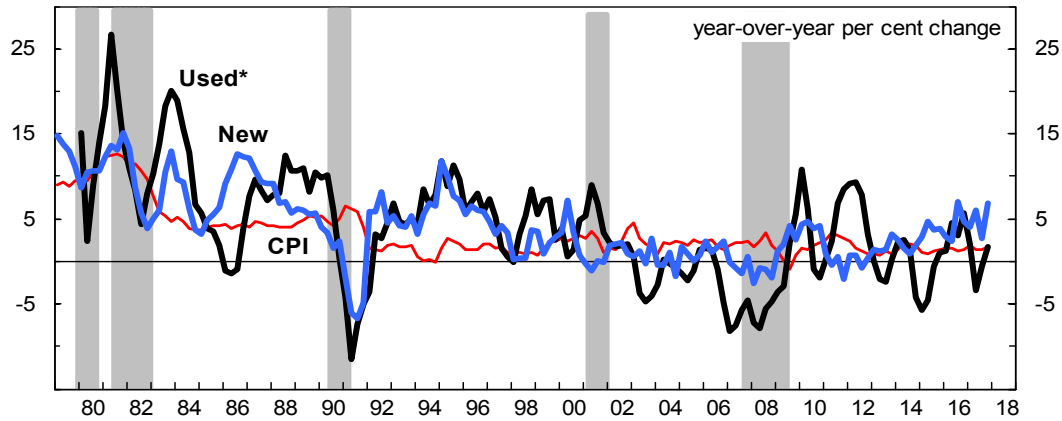
Canada — World Auto Trade Balances



2018 data are January annualized.
Source: Statistics Canada.

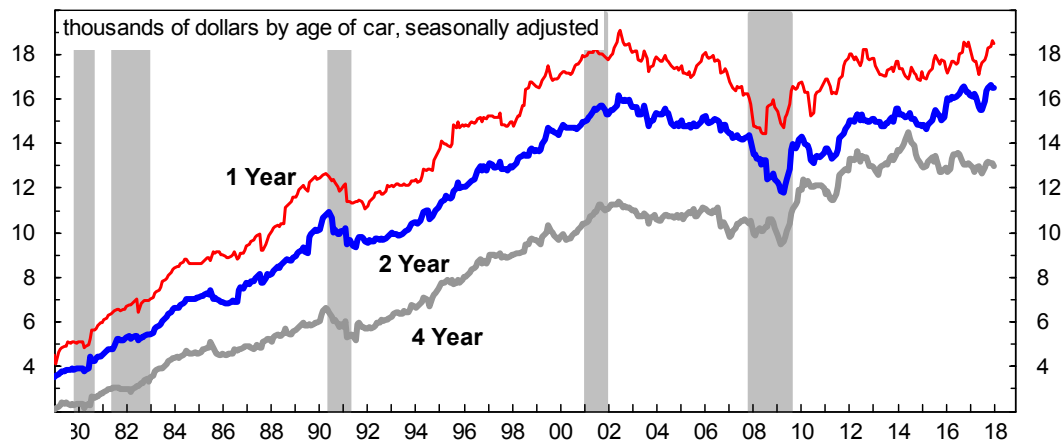
New & Used Car Prices

Scotiabank Car Price Indicators — Canada



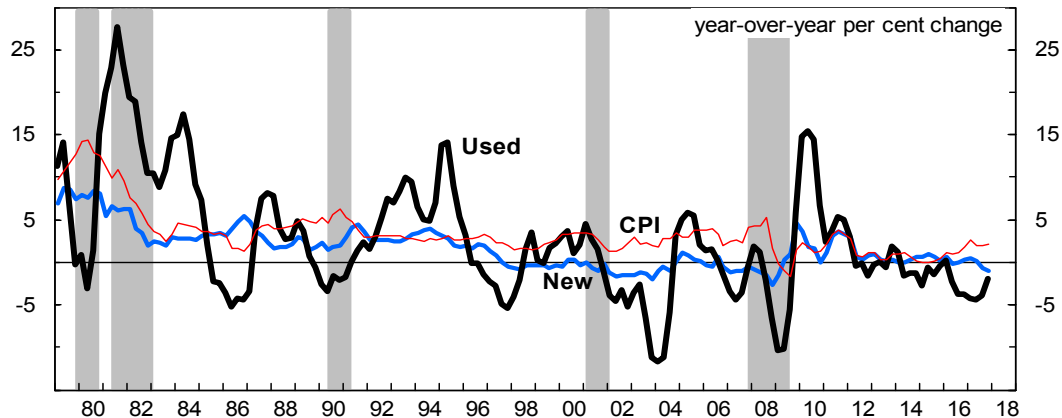
*Scotiabank estimate from Canadian Black Book data.
Sources: Canadian Black Book, Statistics Canada.

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 | 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 |
| | 2017 | 3404 | 2.51 | 4.89 | 7.68 | 2.04 | 21.35 |
| Quarterly at annual rates | 2016Q4 | 2852 | 2.65 | 4.84 | 6.99 | 1.94 | 18.62 |
| | 2017Q1 | 2196 | 2.65 | 4.31 | 6.20 | 2.14 | 14.63 |
| | Q2 | 3904 | 2.43 | 5.32 | 8.99 | 2.11 | 25.44 |
| | Q3 | 3904 | 2.43 | 5.12 | 8.15 | 2.00 | 23.84 |
| | Q4 | 3612 | 2.65 | 4.81 | 7.24 | 1.94 | 21.18 |
| Average (89–17) | | 1086 | 1.40 | 5.96 | 3.67 | 2.31 | 12.68 |
| Low (89–17) | | -68 | 0.10 | 4.31 | 1.10 | 3.57 | -1.20 |

Definition of Ratios:

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

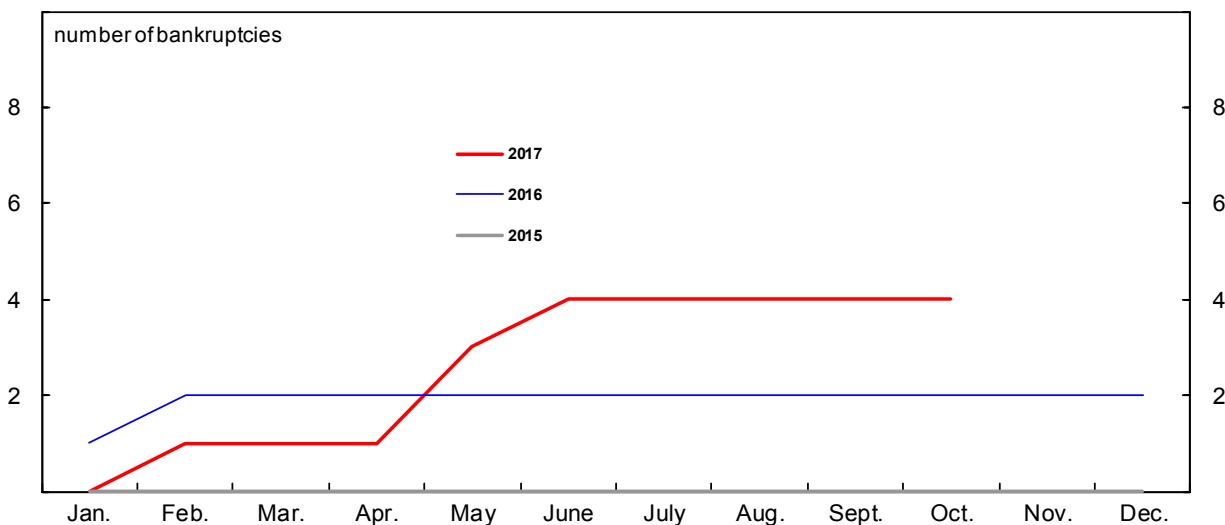
Inventory Turnover Ratio: sales/inventory

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.

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