

NAFTA Drives Auto Industry Integration Amid Global Expansion

- Global volumes continue to gain momentum.
- The auto industry has the most highly integrated supply chain in North America: three-quarters of US auto parts exports are destined to its NAFTA partners, including one-third to Mexico.

RECENT GLOBAL NEW VEHICLE SALES DEVELOPMENTS

Global car sales accelerated sharply in February, in line with global growth. Volumes jumped 6.9% above a year earlier, well above the 4% y/y gain during the previous two months. The acceleration was broad-based and was led by a 16% y/y surge in Asia. In particular, sales in China returned to a double-digit year-over-year growth path, as automakers increased incentives to cushion the negative impact of the January 2017 phase-in of the sales tax increase for small vehicles with 1.6 litre or smaller engines. The industry is also lobbying the government to introduce new incentives to stimulate demand from rural residents. These developments imply that this year's expected moderation in vehicle sales in China is likely to be smaller than originally feared, especially since economic activity has remained resilient. Sales were also stronger than expected across South America, advancing above a year earlier in February for the fourth consecutive month.

More recent sales data for March confirm the trend of record volumes in both Canada and Mexico, but some disappointment in the US results. Sales in Canada last month jumped 7% above a year earlier, buoyed by double-digit gains for both light trucks and luxury models. This solid performance lifted year-to-date sales to an annualized 2.1 million units—the best three-month performance on record, and well above the full-year 2016 total of 1.95 million. Sales gains were even stronger in Mexico, jumping 17% above a year ago in March, even as interest rates have moved higher and economic activity has slowed.

In contrast, car and light truck sales declined in the United States to an annualized 16.6 million units last month, the lowest sales pace of the past year and well below expectations. Weak business purchases accounted for much of the slowdown, with fleet volumes for the Detroit Three slumping 14% below a year earlier. However, sales to households continue to move higher and are expected to climb further during the upcoming spring selling season, especially since the industry is well stocked. Despite numerous media reports highlighting that new vehicle inventories are high, the industry remains comfortable with its production schedule and still plans to produce a record annualized 18.5 million units in Canada, the United States, and Mexico during the April–June period.

NAFTA UNCERTAINTY

The Trump Administration's objective of renegotiating NAFTA, either by tweaking or revamping the agreement has created significant uncertainty across North America, especially in the auto sector. **The auto industry has the most highly integrated supply chain of all manufacturing industries in North America. This integration has enabled the sector to outperform on the global stage. Any new restriction of the free flow of vehicles and parts among the three countries would have a negative impact on economic activity in all three jurisdictions.**

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Chart 1

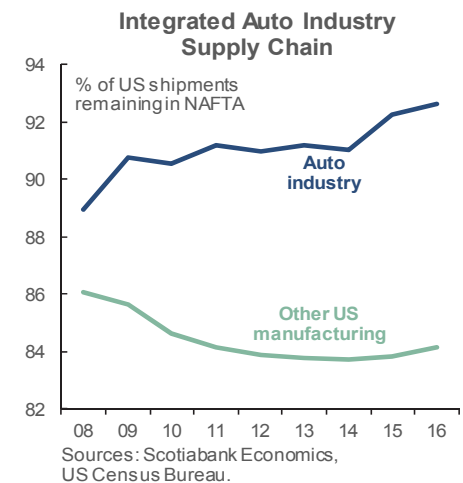
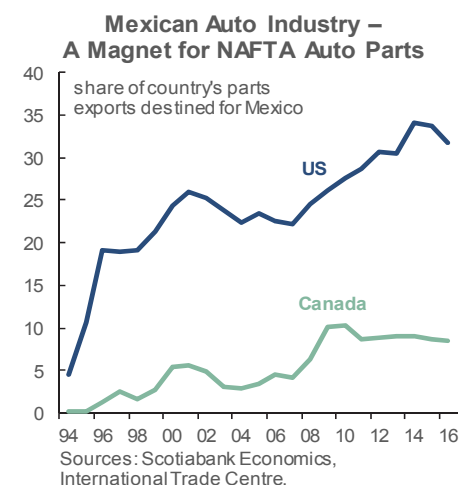


Chart 2



INTEGRATED SUPPLY CHAIN

More than 92% of all auto industry shipments from the United States are now destined to the three NAFTA countries, with this integration continuing to strengthen (see chart 1). This is nearly 10 percentage points higher than other manufacturing sectors. Auto parts and components produced in one jurisdiction cross NAFTA borders as many as eight times before being installed in a final assembled product in one of the three countries. This integration has boosted productivity and enhanced the industry's competitiveness, enabling it to increase its share of global exports. For example, auto-industry exports from NAFTA to the rest of the world have advanced by 4% annually over the past decade, a percentage point faster than the increase in global auto-industry exports.

Among NAFTA members, Mexico has led the advance in auto-industry exports. Cross-border shipments from Mexico have increased in excess of 7% annually over the past decade, as many foreign automakers have established new assembly plants in the southern-most NAFTA country to take advantage of Mexico's numerous bilateral free-trade agreements, which allow the export of vehicles duty-free to more than 40 countries around the world. The Detroit automakers once dominated vehicle production in Mexico, but now account for less than 45% of overall car and truck output.

NAFTA SUPPLIES THE MEXICAN AUTO INDUSTRY

The US auto industry is the major supplier of auto parts to both its NAFTA partners and has been a major beneficiary of the rapid expansion of assembly plants in Mexico. Nearly 75% of all auto parts exported from the United States are destined to either Canada or Mexico. In particular, Mexico is now the destination for one-third of overall auto parts exported from the United States, up from less than 5% when NAFTA took effect in 1994 (see chart 2). Overall US auto-industry shipments to Mexico have increased by 7% annually during the past 23 years, nearly double the rate of US auto-sector export growth to the rest of the world. The export growth to Mexico has been even faster from Canada, though Mexico's share of overall Canadian auto parts shipments remains in the single-digits.

The highly integrated North American auto supply chain has enabled US auto industry employment to increase by nearly 6% annually during the current economic expansion, more than five times the growth in overall manufacturing employment and triple the pace of total employment gains in the United States during this period. This means that any disruption to the integrated supply chain that has been achieved under NAFTA could challenge the outperformance of the North American auto industry, including potential job losses for some of the nearly 2 million positions at plants in the United States, Canada, and Mexico.

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	78.30
North America*	16.36	17.74	19.42	20.64	21.05	21.31
Canada	1.27	1.61	1.85	1.90	1.95	1.94
United States	14.55	15.15	16.44	17.39	17.50	17.80
Mexico	0.54	0.98	1.13	1.35	1.60	1.57
Western Europe	13.11	13.79	12.11	13.20	13.97	14.25
Germany	3.57	3.25	3.04	3.21	3.35	3.42
Eastern Europe	1.18	3.03	3.81	3.15	3.14	3.30
Russia	0.78	1.83	2.49	1.60	1.43	1.50
Asia	6.91	16.08	31.69	32.29	36.06	36.24
China**	0.43	6.52	18.37	20.01	23.57	23.34
India	0.31	1.18	1.87	2.06	2.09	2.19
South America	1.64	3.10	4.15	3.33	3.07	3.20
Brazil	0.94	1.90	2.50	1.82	1.39	1.39

*Includes light trucks. **Includes crossover utility vehicles from 2005. Sources: 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-Feb **	Annual f
(thousands of units, annualized)						
CANADA	1,398	1,643	1,898	1,949	2,000	1,940
Cars	797	783	714	662	660	650
Domestic	583	491	476	438	460	435
Imports	214	292	238	224	200	215
Light Trucks	601	860	1,184	1,287	1,340	1,290
(millions of units, annualized)						
UNITED STATES	15.5	14.1	17.4	17.5	17.5	17.8
Cars	8.3	6.9	7.5	6.9	6.3	6.4
Light Trucks	7.2	7.2	9.9	10.6	11.2	11.4
(millions of units, annualized)						
NORTH AMERICAN PRODUCTION*	15.58	14.25	17.95	18.17	17.69	18.50
CANADA	2.50	2.24	2.28	2.37	2.51	2.35
UNITED STATES	11.67	9.53	12.10	12.20	11.51	12.40
MEXICO	1.41	2.48	3.57	3.60	3.67	3.75

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

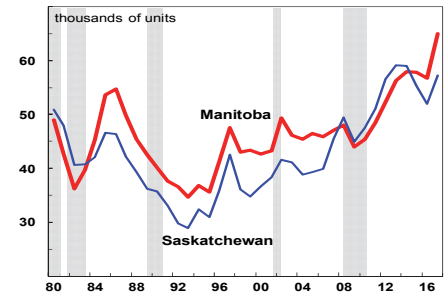
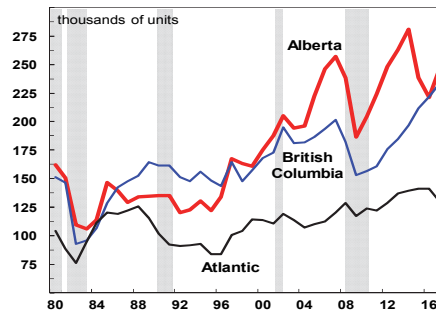
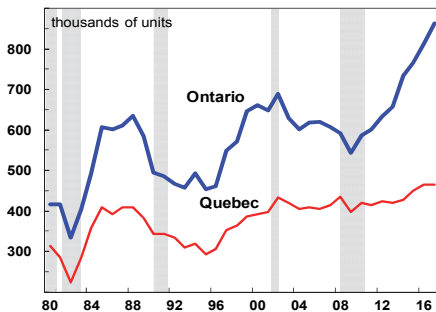
VEHICLE SALES OUTLOOK BY PROVINCE*

(thousands of units, annual rates)

	<u>1994-05</u>	<u>2006-14</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	
	Average				Jan-Feb **	Annual f
CANADA	1,446	1,643	1,898	1,949	2,000	1,940
ATLANTIC	102	123	140	140	130	135
CENTRAL	936	1,017	1,205	1,265	1,290	1,256
Quebec	366	411	444	458	450	456
Ontario	570	606	761	807	840	800
WEST	408	503	553	544	580	549
Manitoba	42	48	56	55	64	56
Saskatchewan	36	49	54	51	56	52
Alberta	166	231	236	220	235	223
British Columbia	164	175	207	218	225	218

*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 Mar		Jan to Mar		Mar		Mar	
	Units	% of Total	Units	% of Total	Units	% of Total	Units	% of Total
TOTAL	134.6	100.0	131.5	100.0	61.8	100.0	61.2	100.0
Big Three	27.2	20.3	26.0	19.7	13.0	21.2	12.2	19.9
General Motors	14.5	10.8	13.4	10.2	6.9	11.3	6.7	10.9
Ford	8.3	6.2	7.0	5.3	3.7	6.0	3.0	4.9
Chrysler	4.4	3.3	5.6	4.2	2.4	3.9	2.5	4.1
Japanese	59.8	44.4	62.1	47.3	27.0	43.7	30.2	49.4
Honda	18.5	13.8	20.0	15.2	8.5	13.8	10.4	17.0
Toyota	18.0	13.4	17.2	13.1	8.3	13.4	7.9	12.9
Nissan	11.7	8.7	13.0	9.9	5.0	8.0	5.7	9.3
Mazda	6.2	4.6	7.7	5.9	2.9	4.7	3.8	6.3
Mitsubishi	2.4	1.8	1.7	1.3	1.1	1.8	0.7	1.2
Subaru	3.0	2.2	3.7	2.8	1.3	2.1	1.6	2.6
Hyundai	16.5	12.3	13.2	10.0	7.9	12.7	5.9	9.7
Volkswagen	9.7	7.2	8.3	6.3	4.4	7.2	3.5	5.6
Kia	8.1	6.0	7.3	5.6	3.5	5.6	3.4	5.5
BMW	4.7	3.4	4.3	3.3	1.9	3.0	1.6	2.7
Mercedes-Benz	5.2	3.9	5.8	4.4	2.4	3.8	2.3	3.8
Other	3.4	2.5	4.5	3.4	1.7	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 Mar		Jan to Mar		Mar		Mar	
	Units	% of Total	Units	% of Total	Units	% of Total	Units	% of Total
TOTAL	275.5	100.0	295.5	100.0	116.3	100.0	128.3	100.0
Big Three	152.3	55.3	162.0	54.8	64.3	55.2	70.9	55.3
General Motors	40.1	14.6	47.8	16.2	17.5	15.1	23.4	18.3
Ford	53.2	19.3	55.7	18.8	22.7	19.5	23.5	18.3
Chrysler	59.0	21.4	58.5	19.8	24.1	20.6	24.0	18.7
Other Domestic	9.2	3.3	9.0	3.1	3.8	3.3	3.8	3.0
Japanese	76.8	27.9	85.1	28.8	32.4	27.8	36.5	28.5
Honda	17.4	6.3	20.9	7.1	7.8	6.7	8.8	6.8
Toyota	27.4	9.9	27.7	9.4	10.8	9.3	11.5	8.9
Nissan	18.3	6.7	21.9	7.4	7.6	6.6	10.1	7.9
Mazda	7.2	2.6	7.8	2.6	3.2	2.7	3.1	2.4
Mitsubishi	2.6	0.9	2.7	0.9	1.0	0.9	1.2	0.9
Subaru	6.5	2.4	6.7	2.3	2.9	2.5	3.0	2.4
Hyundai	11.3	4.1	11.0	3.7	5.1	4.4	5.2	4.0
Kia	5.9	2.1	6.5	2.2	2.5	2.2	3.0	2.3
Other Imports	20.0	7.3	21.9	7.4	8.2	7.1	8.9	6.9
LIGHT TRUCKS	268.3	97.4	289.6	98.0	113.3	97.3	126.1	98.4

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

AUTO SALES BY PROVINCE

(thousands of units, not seasonally adjusted)

	<u>2015</u> Jan to Dec	<u>2016</u> Jan to Dec	<u>2016</u> Jan	<u>2017</u> Jan
CANADA	712.2	661.1	33.8	32.1
ATLANTIC	54.7	47.2	2.1	1.9
Newfoundland	11.5	9.5	0.4	0.3
Nova Scotia	23.3	20.3	0.9	0.9
New Brunswick	16.5	14.3	0.7	0.6
Prince Edward Island	3.4	3.1	0.1	0.1
CENTRAL	502.3	467.6	23.1	21.9
Quebec	218.5	198.5	9.3	8.5
Ontario	283.8	269.1	13.8	13.4
WEST	155.2	146.3	8.6	8.3
Manitoba	16.0	14.4	0.8	0.7
Saskatchewan	10.6	9.3	0.5	0.5
Alberta	51.8	47.7	2.8	2.7
British Columbia	76.8	74.9	4.5	4.4

Source: Statistics Canada.

TRUCK SALES BY PROVINCE*

(thousands of units, not seasonally adjusted)

	<u>2015</u> Jan to Dec	<u>2016</u> Jan to Dec	<u>2016</u> Jan	<u>2017</u> Jan
CANADA	1,226.1	1,316.9	76.9	80.1
ATLANTIC	87.9	94.5	5.1	5.0
Newfoundland	23.4	24.2	1.2	1.2
Nova Scotia	31.8	34.2	1.8	2.0
New Brunswick	28.2	30.4	1.8	1.5
Prince Edward Island	4.5	5.7	0.3	0.3
CENTRAL	727.4	814.1	45.1	46.7
Quebec	232.9	261.4	14.3	13.9
Ontario	494.5	552.7	30.8	32.8
WEST	410.8	408.3	26.7	28.4
Manitoba	42.0	43.0	2.7	2.8
Saskatchewan	44.5	42.8	2.8	3.0
Alberta	190.1	175.9	11.7	12.3
British Columbia	134.2	146.6	9.5	10.3

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

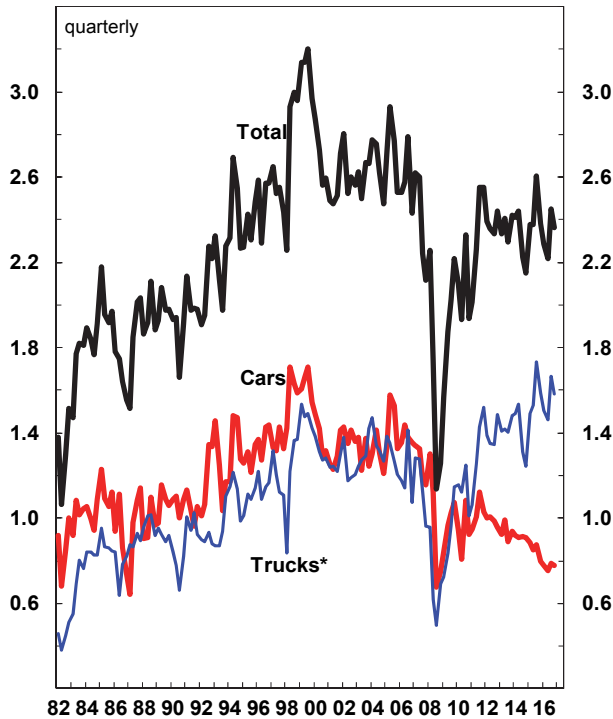
CANADIAN MOTOR VEHICLE PRODUCTION

(thousands of units, not seasonally adjusted)

	<u>2016</u> Jan to Feb	<u>2017</u> Jan to Feb	<u>2016</u> Feb	<u>2017</u> Feb
TOTAL	415.4	377.5	212.2	185.9
CAR	144.9	122.7	73.1	60.8
Chrysler	43.4	34.3	21.5	18.7
GM	25.9	12.6	13.5	7.0
Honda	35.0	35.2	17.7	16.0
Toyota	40.6	40.6	20.4	19.1
TRUCKS*	270.5	254.8	139.1	125.1
Chrysler	61.6	48.0	30.0	26.0
Ford	44.5	42.9	24.5	21.0
GM	67.2	63.8	35.7	30.9
Honda	35.6	36.5	18.0	16.9
Toyota	59.3	61.2	29.7	28.9
Others	2.3	2.4	1.2	1.4

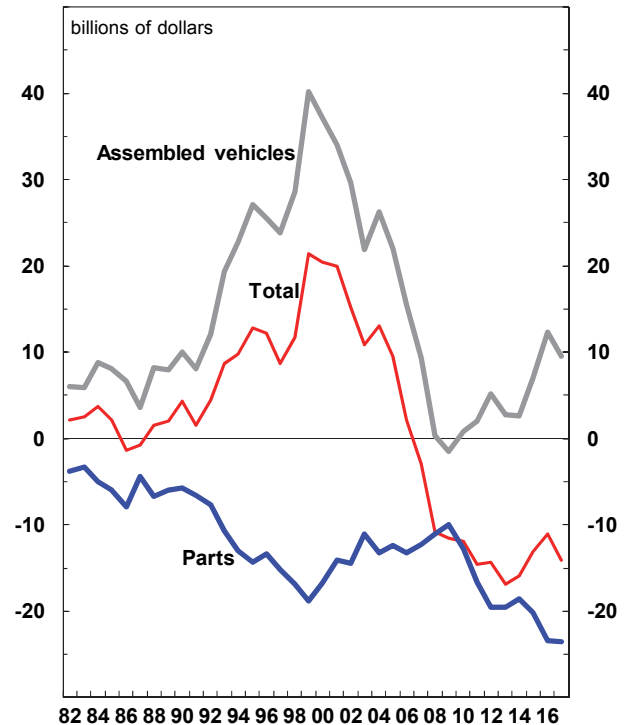
*Light, medium and heavy trucks. Source: Ward's Automotive Reports.

Canada — Motor Vehicle Production



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

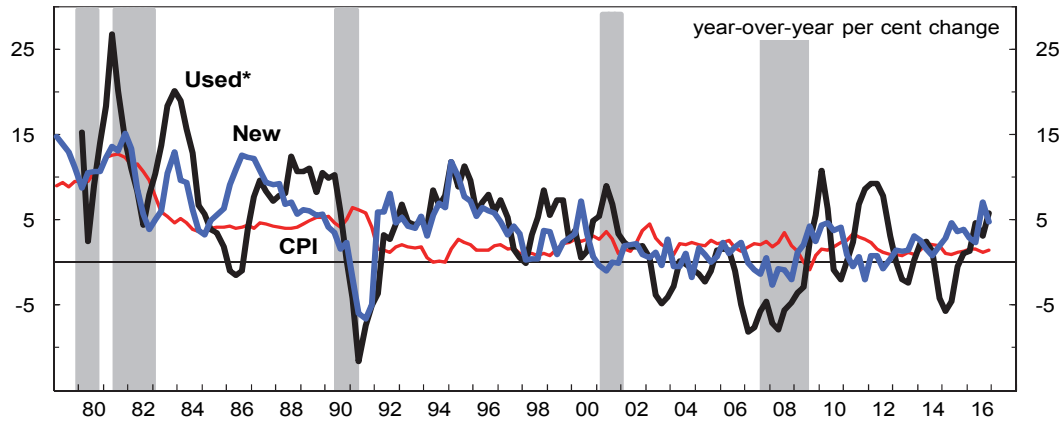
Canada — World Auto Trade Balances



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

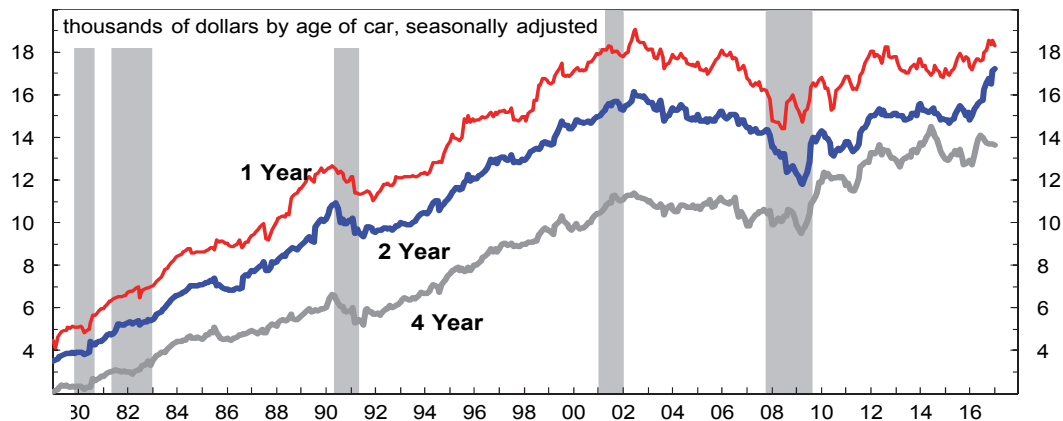
New & Used Car Prices

Scotiabank Car Price Indicators — Canada



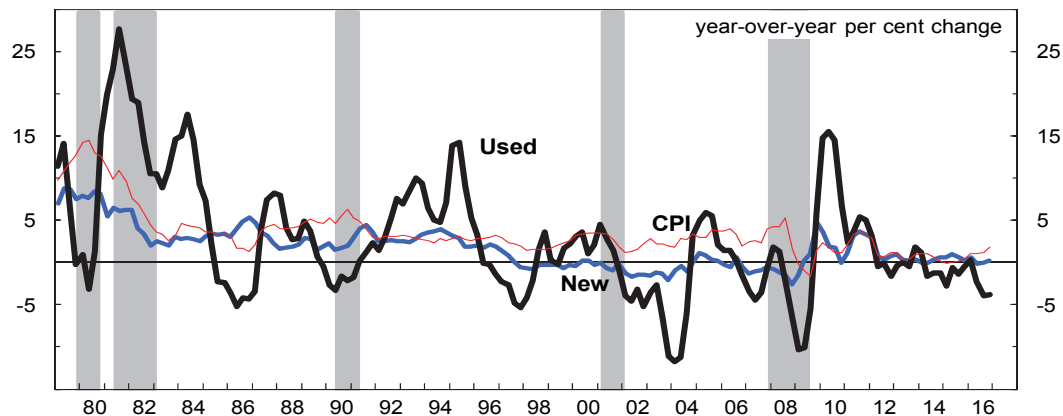
*Scotiabank estimate from Canadian Black Book data.
Sources: Canadian Black Book, Statistics Canada.

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	2740	2.65	5.10	7.56	1.86	20.90
	2015	2854	2.57	5.07	7.81	1.87	20.50
2016	2687	2.20	4.97	7.46	1.91	17.91	
Quarterly at annual rates	2015Q4	2988	2.65	4.98	7.57	1.84	20.63
	2016Q1	2008	1.93	4.56	6.54	1.94	13.95
	Q2	3228	2.43	5.40	8.74	1.92	21.79
	Q3	2756	2.43	5.07	7.67	1.89	18.12
	Q4	2756	2.65	4.82	6.88	1.88	17.68
Average (89–15)		929	1.28	6.03	3.30	2.33	12.05
Low (89–15)		-68	0.10	4.38	1.10	3.57	-1.20

Definition of Ratios:

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

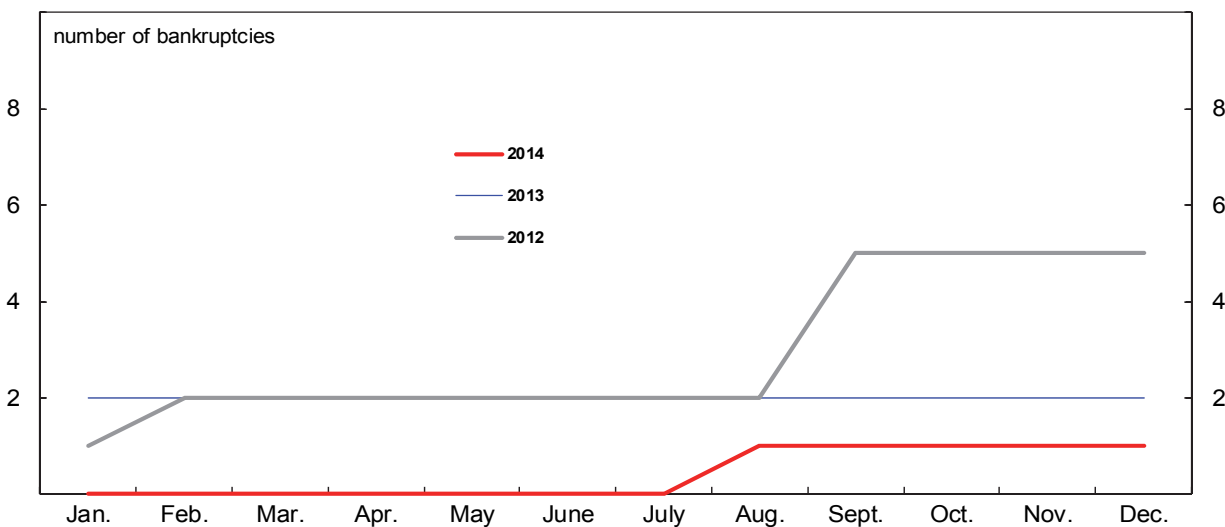
Inventory Turnover Ratio: sales/inventory

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.

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