

## In the Rear View Mirror: Canadian Auto Sales in 2019

- Canadian auto sales in 2019 disappointed with a 3.2% y/y decline.
- This marks a second consecutive year of auto sales declines following the 2017 high that saw sales soar above 2 mn units with the Canadian economy firing on all cylinders.
- The cyclical slowdown in auto sales has been driven by affordability considerations, which in turn have been amplified through wealth and confidence channels.
- Canada has not yet hit “peak car”, but a return to 2017 highs is not imminent.
- Meanwhile, auto sales are in for another bumpy ride in 2020.

### AHEAD OF THE CURVE

**Canadian auto sales closed the year on a low note in 2019.** On a seasonally adjusted basis, fourth quarter auto sales contracted by almost 8% y/y, in spite of the year-prior’s fourth quarter retrenchment of 5% y/y against the backdrop of late-2018 trade and oil tensions. As 2019 advanced, hopes for a solid auto sales rebound slowly evaporated. Year-end sales totaled 1.92 mn units, a 3.2% decline over 2018 and 5.7% below 2017’s all-time high of 2.04 mn units (chart 1).

**Auto sales broadly follow the economic growth cycle.** The last two major downturns eroded auto sales peak-to-trough by 24% and 12% respectively, bringing levels well-below trend growth (chart 2). Major downturns in auto sales have always been accompanied by economic recessions, whereas weaker-but-still-positive economic growth has also temporarily sent auto sales into negative territory (chart 3). There is similarly a correlation to the output gap with sales expanding as the gap narrows and moves into excess territory—often supported by accommodative policies—and contracting as policy conditions tighten and excess capacity is worked off (chart 4).

**Over the long run, Canadian auto sales are driven by national wealth, household income, and credit conditions.** In particular, Scotiabank Economics’ models find that oil prices (as a proxy for national income), disposable income (as a measure of household income), and the 10-year government bond yield (as an indicator of credit conditions) can best predict trend auto sales on a per capita basis. Over the course of the economic cycle, fluctuations in auto sales around trend levels can be driven by changes in disposable income, house prices, stock markets, policy rates and consumer expectations—according to our models.

**Auto sales in 2019 are still working off the 2017 high following an eight-year expansion.** In this latest peak, sales surged above trend replacement rates for several years; in fact, 2019 levels still sit modestly above fundamental levels. The peak was fueled by an environment of strong economic growth, recovering oil prices, easing policy rates and escalating house prices in 2017. Subsequently, a tightening monetary stance, an oil price decline, and a policy-induced housing cool-down all put the brakes on auto sales in 2018. This slowdown continued through 2019 as consumers faced a variety of headwinds.

### CREDIT CONDITIONS IMPROVED BUT WITH MARGINAL IMPACT

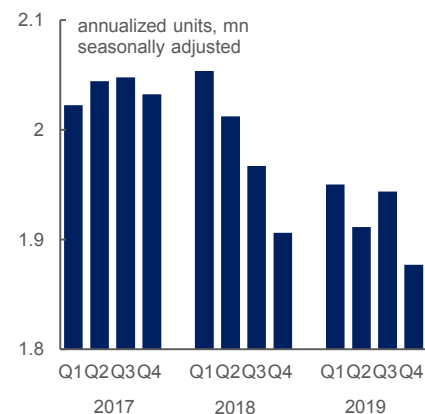
**Lower credit costs were insufficient to reverse the declining trend in auto sales in 2019.** The ten-year bond rate was down by an average of about 70 basis

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Chart 1

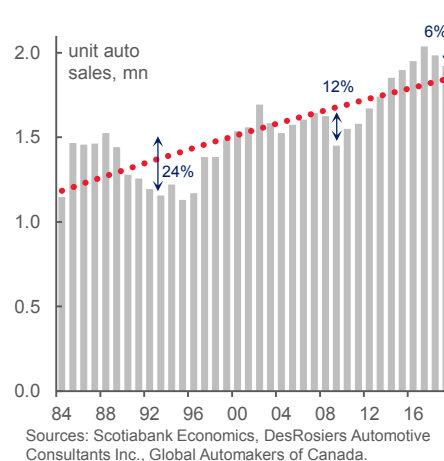
#### Slowing Canadian Auto Sales



Sources: Scotiabank Economics, DesRosiers Automotive Consultants Inc., Global Automakers of Canada.

Chart 2

#### A Cyclical Business



Sources: Scotiabank Economics, DesRosiers Automotive Consultants Inc., Global Automakers of Canada.

points in 2019 relative to 2018. The peak-to-trough difference was particularly pronounced at 150 basis points in August this year as global uncertainty and recessionary fears worked their way through bond markets around the world, pushing down consumer credit costs. Canadian mortgage credit temporarily accelerated in response (though since [decelerated](#)), but auto purchases barely budged. August auto sales did surpass 2 mn units on a seasonally adjusted basis—and was the only month showing year-over-year gains in the selling rate—but the one-off reading did little to affect the trend decline.

**Consumer credit more broadly has also been slowing since 2017.** This is consistent with a broad-based decline in consumption growth, particularly concentrated in goods (chart 5). One component of the credit slowdown relates to housing lines of credit (i.e., HELOCs) that started pulling back in 2018 as they came under increased scrutiny from the Office of the Superintendent of Financial Institutions (OSFI). Vehicle purchases are among the top three uses of housing lines of credit, according to the Financial Consumer Protection Agency.

**There was also little evidence of pent-up demand from any deferred purchases in 2018.** Escalating financing costs in 2018 had cut into affordability as the Bank of Canada embarked on a policy rate tightening path, increasing its overnight policy rate by 125 bps to 1.75% where it still sits today. The central bank shifted to a more dovish tone by mid-2019 but an easing bias among market watchers was far from consensus. Any sidelined consumers from 2018 would not likely have further deferred purchases based on rate cut expectations.

## CONSUMERS FEELING THE PINCH

**Limited discretionary spending likely had a role in weaker auto sales in 2019.** High household debt levels, and more importantly debt service costs, have eaten into non-essential spending (chart 6). Even though job growth was strong (up 64% y/y), wage appreciation was solid (3.4% y/y), and disposable income grew at 4.3% y/y, auto inflation spiked above 4% y/y in 2019 and has remained well above headline inflation for most of the year. Housing prices have also appreciated above inflation, for example mortgage interest costs as a component of inflation jumped by almost 5% y/y through November.

**A strong US dollar has contributed at least in part to auto price inflation.** Auto prices both as a component of inflation and on a per unit basis have been trending higher in recent years above and beyond the historical impact of exchange rate influences. A weaker Canadian dollar has traditionally pushed up auto prices with a one-year lag given a majority of vehicles (and/or their components) are produced abroad (chart 7). Other developments may be compounding this effect including consumer preferences for larger vehicles and upward price pressures on inputs such as labour and materials (e.g., steel and aluminum).

**Used auto purchases have picked up some of the slack.** Desrosiers Automotive Consultants Inc. (DAC) reports that used auto sales in fact climbed by almost 10% in 2019. As the average lifespan of the automobile continues to increase (up by about 5% since 2010 to an average age of 9.7 years according to DAC), there is a growing supply of quality second-hand vehicles in the market.

## HOUSE RICH, CASH POOR

**Housing effects have also amplified cyclical auto spending patterns over the past several years.** Home prices in the Greater Toronto Area (GTA) and the Greater Vancouver Area (GVA) surged by close to 20% y/y at the market height in 2016–17. Canadians tapped into this home equity at an unprecedented pace through housing lines

Chart 3

### Auto Sales Swings Mirroring GDP Growth

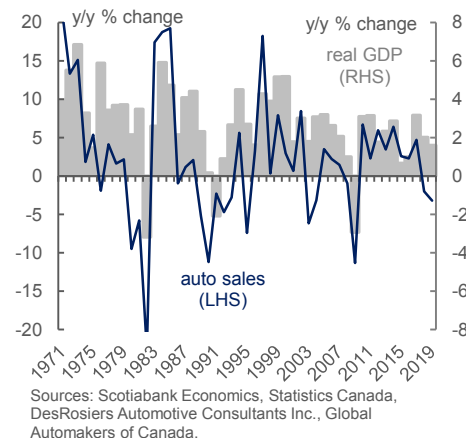


Chart 4

### A Barometer for the Health of the Economy

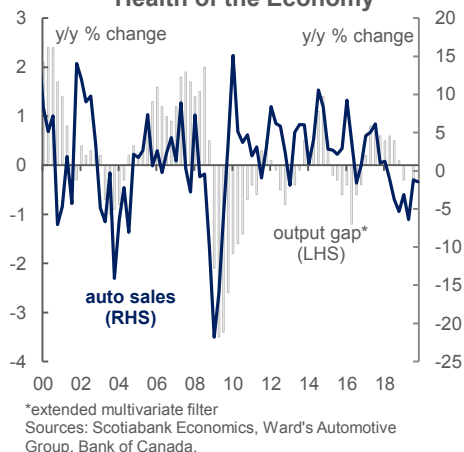
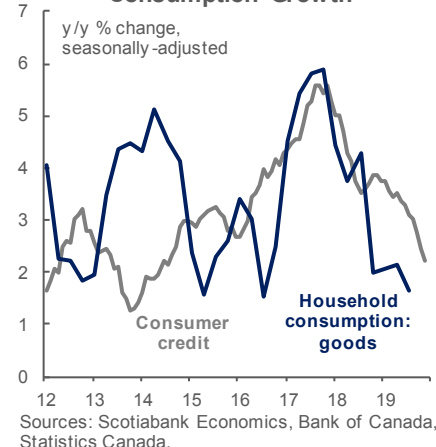


Chart 5

### Waning Consumer Credit & Consumption Growth



of credit and mortgage refinancing, almost doubling equity extraction between 2014 and 2017. These factors, along with a then-easing policy rate path, fueled auto sales to the all-time high in 2017.

**The 2018 housing market correction contributed to the auto sales decline.** The introduction of tighter federal lending rules (e.g., B20), as well as locally targeted taxes (e.g., speculation and foreign-buyers taxes) in 2018 precipitated policy-induced, counter-cyclical housing slowdowns in the GTA and GVA. This led to double-digit contractions in year-over-year home sales, and average home values dipped in both cities—eroding households' net worth despite relatively decent economic growth of 2.0% (chart 8).

**Housing markets started a tentative rebound in 2019 but the economic cycle was already maturing.** Furthermore, house price appreciation in key markets is increasingly driven by structural issues (i.e., an undersupply) versus cyclical factors. As opposed to house prices spurring cyclical auto sales through wealth effects, housing costs may increasingly erode disposable income thus weighing on auto sales.

**As we look ahead to 2020, a weaker stage in the economic growth cycle will likely dominate auto sales relative to modest strengthening of home equity.**

## CONFIDENCE ONLY GETS YOU SO FAR

**Canadian consumers felt relatively confident for most of 2019.** Sentiment levels, as measured by the Conference Board of Canada, hovered around an average of 115 throughout the year until November (whereas the decade average has been about 101). There was a sharp drop of almost 10 points in December in 2019, but subsequent recovery to 114 in the most recent January reading.

**Perceptions matter.** The Bank of Canada's inaugural consumer expectations [survey](#) offers some interesting perspectives on the Canadian consumer. In particular, despite solid wage growth well-above inflation, as reported by StatsCan, Canadians do not actually anticipate real wage gains, after taking into account inflation expectations, in the year ahead. On the other hand, they do expect their spending to significantly outpace expected wage growth at a pace of 3.4%. Actual retail spending (through October) was up by an anaemic 1.4% y/y so arguably perceptions matter only to an extent.

## A TWO-SPEED ECONOMY

**Headline figures for Canadian auto sales mask significant differences in markets across the country.** In broad swathes, these trends reflect [different economic fortunes](#) across Canada. Ontario and Alberta stand in stark contrast. Preliminary estimates suggest Alberta's auto sales declined by about 6% y/y in 2019 on the heels of a 5% y/y drop in 2018, while Ontario's drop—around 2% y/y—was more modest than the national average (chart 9).

**Ontario still drives national trends, accounting for about 43% of the Canadian auto sales market.** The Ontario economy has weathered an uncertain 2019 remarkably well, delivering on a stable growth trajectory despite a weak external environment and an appreciating Canadian dollar in the latter part of the year. It was insulated from the November pullback in national job growth, while net population inflows continue to outpace national averages. However, savings rates hover close to zero, in part due to increasing shelter costs, which will cyclically dampen future sales.

**A recovery in oil prices should put a floor under the auto sales decline in Western provinces.** Alberta is expected to return to growth next year, as well as Saskatchewan. Activity in British Columbia is already picking up, driven by natural gas developments. These factors bode well for regional auto sales, but much of 2020 will be about making up for lost ground as opposed to real growth in auto purchases.

Chart 6

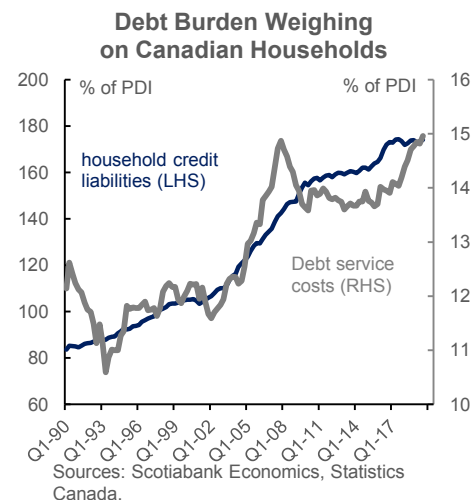


Chart 7

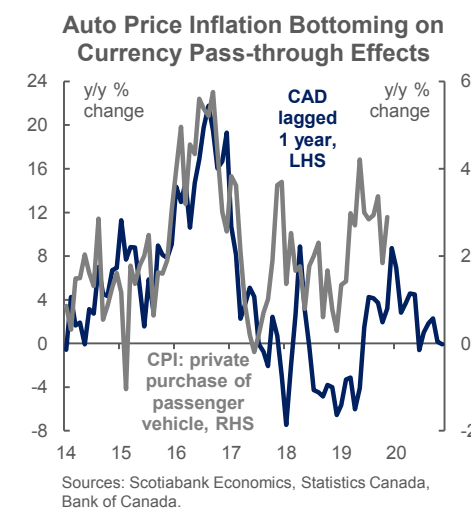
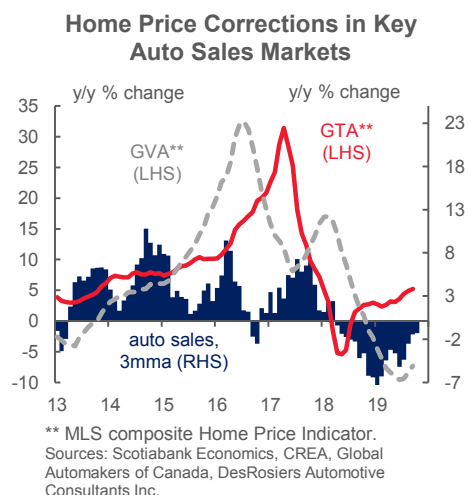


Chart 8



## PEAK CAR PAST?

### Canada will surpass two million annual auto sales again...but not anytime soon.

Car ownership is largely in line with peers on a per capita basis (chart 10). Some suggest a deceleration in the growth of Canada's "vehicle-driving population" puts a ceiling on sales, but the metric—defined as 15–64 year olds—misses prime consumers. Baby Boomers are increasingly holding on to their licence longer, and importantly, they have higher net worth and greater disposable income than the generations that follow.

**Record-high immigration inflows also hold upside to auto sales.** Immigrants make up about 80% of Canada's population growth which expanded at a pace of 1.4% last year (chart 11). G7 peers grew on average only by 0.2%. While data on new immigrants' purchasing habits is scarce, many auto dealers and financial institutions are targeting the unique needs of this potential consumer insofar as they do not typically arrive with a vehicle, and they are quickly integrated into the workforce, but it may take time to establish credit.

**Ridesharing is not likely cannibalizing Canadian auto sales.** Preliminary studies from the US suggest that car-sharing services are substituting taxis and public transit. They are also concentrated in urban centres where congestion has already discouraged the use of personal cars. As Canadian cities are building out, not up, more Canadians are pushed out to suburban environments where car ownership is still largely essential.

## THE ROAD AHEAD

**Canadian auto sales likely face another year of volatile sales ahead.** Economic growth is once again set to slow to 1.5% of GDP, albeit marginally from an estimated 1.6% in 2019, in Scotiabank Economics' recent [forecasts](#). This is well-shy of the estimated 40 basis point drop in economic growth from 2018, but potentially persistent softening of domestic sentiment and consumption would weigh more heavily on auto sales.

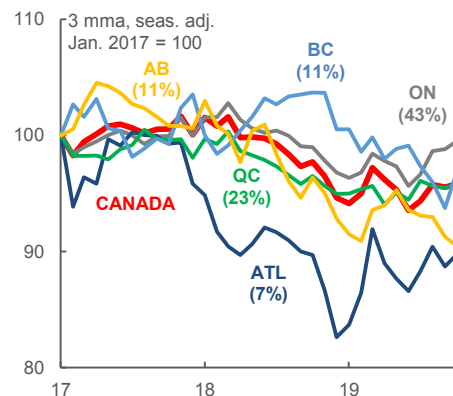
**Any hope for tailwinds from potential policy rate cuts by the Bank of Canada may be exaggerated.** As outlined in our recent [rates outlook](#), Canada largely imported a positive bond shock already in 2019 from global market reactions to heightened recessionary fears, as well as foreign central banks' responses. This pushed down bond yields below the Bank of Canada's overnight rate. Mortgage and housing markets have arguably already responded. Auto purchases would have faced similar incentives to lock in lower financing costs, but this did not materially transpire in overall sales volume. A policy rate cut(s) may remove the kink in the yield curve, particularly favourable for short-term capital, but the appetite for fixed-term financing products in the Canadian market may already be satiated.

**Policy rate cuts could ease pressure on an appreciating Canadian dollar.** This would support broader economic growth, particularly for manufacturing and export-oriented sectors, but do little to alleviate vehicle affordability pressures to the extent that a stronger US dollar is an imported price pressure.

**We presently forecast another decline in auto sales across Canada next year to 1.91 mn units.** Consumer confidence and spending remain the biggest downside risk, with no shortage of factors that could knock off these traditionally lagging indicators. With the Canadian job market dynamic shifting in the fourth quarter of 2019 and wage growth moderating, further softening in consumption ahead can be anticipated. While policy rate cuts may have already worked through the Canadian yield curve, pre-emptive easing could potentially underpin waning confidence that has so far held back Canadian auto purchases.

Chart 9

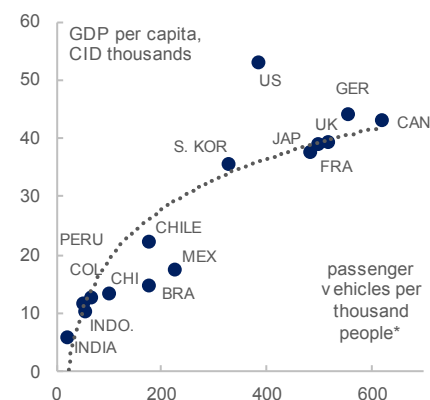
### A Variable Descent Across Canada



Sources: Scotiabank Economics, Statistics Canada. One month lag in data.

Chart 10

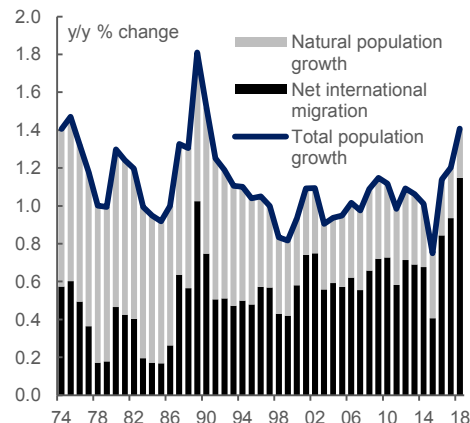
### Wealth Drivers Auto Ownership



\*Latest comparable data from 2015.  
Sources: Scotiabank Economics, IMF, International Organization of Motor Vehicle Manufacturers.

Chart 11

### Structural Drivers



Sources: Scotiabank Economics, Statistics Canada.

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