



# Global Auto Report

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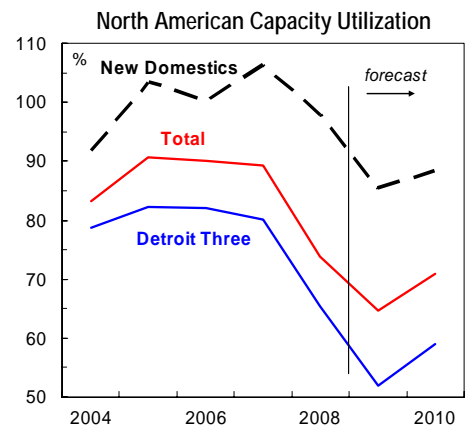
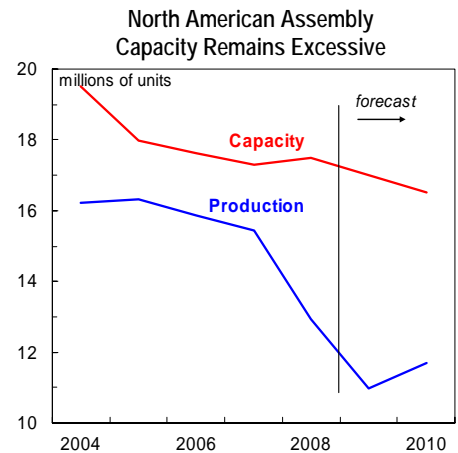
## Out Of Alignment In North America — Additional Capacity Restructuring Will Be Required

**T**he downturn in global car sales continues to intensify. Purchases slumped nearly 30% y/y in January alongside a further deterioration in sales in the United States, Western Europe and Japan. U.S. purchases plunged 40% y/y last month, falling to an annualized 9.5 million units — the lowest level since mid-1982, and down from a 10.3 million unit average in the final months of 2008. The fall-off was driven by more than a 60% y/y decline in fleet volumes, due to the industry-wide production shutdown between mid-December and late-January. However, retail purchases actually improved last month, edging up to an annualized 8.6 million units, up from an average of 8.3 million in the final months of 2008.

Given the weaker-than-expected U.S. sales, dealer inventories edged down only marginally in January. This development prompted automakers to move aggressively to slash an additional 200,000 units from their first-quarter North American production schedules. These further cutbacks will reduce output an additional 10% in both Canada and the United States and by 4% in Mexico. Highlighting the fact that every automaker is being impacted by weak sales, the 'New Domestics' accounted for more than half of the reduction in schedules over the past month. However, despite these cutbacks, the 'New Domestics' still plan to produce more vehicles in the first quarter than the 'Detroit Three'.

Auto sales in Canada also began 2009 on a weak note. Purchases remained around an annualized 1.30 million units for the second consecutive month, down from a full-year 2008 total of 1.64 million units. Volumes are being undermined by a deteriorating labour market, which has shed more than 200,000 jobs over the past three months — the worst performance on record in data going back to the mid-1970s.

However, on a more positive note, last month's fall-off in Canada was not as broad based as in December. In fact, one European manufacturer posted record volumes for the month of January and several other importers managed to post year-over-year gains last month — a rare development in late 2008. In particular, Korean automakers reported a 13% y/y gain last month, as a weakening currency improved their competitiveness in North America.



### LOW SALES — EXCESS CAPACITY CHARACTERIZES NORTH AMERICA

Two North American automakers announced last week the reduction of 500,000 units from their U.S. assembly capacity, as part of their viability filings with governments in Canada and the United States. **We estimate that these reductions will trim North American vehicle assembly capacity to roughly 16.5 million units, but will still leave nearly 6 million of unused capacity this year — one-third of all vehicle assembly plants across North America.**

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These automakers also trimmed their base case U.S. sales forecasts to 'a more conservative' 10.1-10.5 million units for 2009, in light of weaker-than-expected results in late 2008 and early 2009. This suggests that excess capacity in North America may be even greater.

Our estimates are based on a full-year 2009 U.S. sales forecast of 11.5 million units, and vehicle production across North America of just under 11 million units, down sharply from an average of 16.1 million over the past decade. We continue to believe that a moderate sales improvement will emerge later this year, as the U.S. and global economies begin to respond to the unprecedented amount of monetary and fiscal stimulus put in place since last September. These measures should begin to resuscitate economic activity during the strongest months for vehicle sales. The spring and summer months normally account for about 55% of annual sales. Nevertheless, the highly volatile and uncertain economic and financial environment facing automakers around the world suggest there are still downside risks, and that the improvement will be mild and not a large rebound.

Even after the latest round of capacity reduction, the 'Detroit Three' will still have the capability to produce roughly 10 million vehicles per annum in North America, well above their output of 7.2 million units in 2008. Production has been cut in half in the opening months of 2009 and will fall by more than 20% this year to less than 6 million units, pulling their full-year operating rate below 55% for all of 2009, down from an average of more than 80% over the past decade. Even with an expected moderate sales gain in 2010, operating rates for the 'Detroit Three' will remain at about 60%, substantially lower than the 85% generally required to restore profitability, and well below the rate they were facing when they began to close plants earlier this decade (see bottom chart on page 1).

The 'New Domestics' are in better shape, running their 6 million units of North American assembly capacity in excess of 95% last year. However, even these automakers have started to idle production, and have cut their first-quarter output schedules 26% y/y. Operating rates for the 'New Domestics' will likely to fall to about 85% in 2009, prompting one automaker to attempt to cut costs by offering job buyouts to its workers in the United States.

The sharp appreciation of the Japanese yen in recent months has eroded the profitability of vehicles exported from Japan, and may benefit North American facilities if production of some vehicles shifts to North America. One automaker has indicated that it will move assemblies of some small cars from Japan to Mexico, because of the surging yen.

**Any shift in production to North America would help Canadian, U.S. and Mexican plants and suppliers. However, Mexico seems better positioned to benefit more from this shift than its NAFTA partners.** European and Asian manufacturers account for 45% of Mexico's overall assembly capacity, compared with 42% in the United States and 38% in Canada. The 'New Domestics' have the capacity to produce 1.3 million cars & light trucks in Mexico, compared with 1.1 million units in Canada. Much of Mexico's assembly capacity has been put in place over the past five years, as automakers have come to view Mexico as a good location from which to export globally, given the country's numerous free trade agreements. In contrast to Canada, which exports vehicles almost exclusively to the United States; Mexico ships about 15% of its overall vehicle output to South America and Europe. As recently as 2004, Mexico's 'New Domestic' assembly capacity trailed Canada's 881,000 units, and its overall vehicle production capability stood at 2.0 million units — well short of Canada's 3.1 million. Canada's capacity has since fallen to 2.7 million units, while Mexico's is set to reach 2.9 million next year.

### International Car Sales Outlook

	<u>1990-99</u>	<u>Peak 2000</u>	<u>2001-06</u> <i>(millions of units)</i>	<u>2007</u>	<u>2008e</u>	<u>2009f</u>
<b>TOTAL SALES</b>	<b>39.20</b>	<b>46.64</b>	<b>48.63</b>	<b>54.92</b>	<b>52.17</b>	<b>47.68</b>
<b>North America*</b>	<b>16.36</b>	<b>19.77</b>	<b>19.45</b>	<b>18.83</b>	<b>15.85</b>	<b>13.93</b>
Canada	1.27	1.55	1.60	1.65	1.64	1.48
United States	14.55	17.35	16.81	16.09	13.19	11.50
Mexico	0.54	0.87	1.04	1.09	1.02	0.95
<b>Western Europe</b>	<b>13.11</b>	<b>14.75</b>	<b>14.54</b>	<b>14.75</b>	<b>13.54</b>	<b>12.46</b>
Germany	3.57	3.38	3.32	3.15	3.09	3.03
<b>Eastern Europe</b>	<b>1.18</b>	<b>2.38</b>	<b>2.36</b>	<b>3.58</b>	<b>4.01</b>	<b>3.65</b>
Russia	0.78	1.03	1.25	2.31	2.73	2.32
<b>Asia</b>	<b>6.91</b>	<b>7.85</b>	<b>10.23</b>	<b>14.42</b>	<b>15.07</b>	<b>14.23</b>
China	0.33	0.61	2.26	5.15	5.04	5.29
India	0.31	0.60	0.75	1.18	1.30	1.23
<b>South America</b>	<b>1.64</b>	<b>1.89</b>	<b>2.05</b>	<b>3.34</b>	<b>3.70</b>	<b>3.41</b>
Brazil	0.94	1.17	1.30	1.98	2.19	1.97

\*Includes light trucks.