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OBSERVATIONS

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North American Auto Industry Review

The first few months of a new year are always interesting. As the previous year's results filter in, analysts are able to cut through the spin and come to the levelheaded conclusions that reflect the state of our industry far more accurately than glowing corporate press or doomsday union pronouncements. Nothing speaks truth more plainly than the cold hard facts published by Statistics Canada and other organizations.

So: Is the North American auto industry in crisis? Are trends witnessed over the past few years accelerating, slowing, or reversing? In truth, 2007 was an off-year for the greater North American industry, but Canada was relatively insulated from the declines experienced in Mexico and the United States.

Nearly 19.2 million vehicles (including heavy duty trucks) were sold in North America in 2007. This total reflects a 3.0 point decline from the nearly 19.8 million units moved in 2006, and it is indicative of a larger slide that is forecast to continue through to 2009. Volumes are expected to recover in the early years of the next decade, bottoming out in 2009 (18.2 million units) and growing to 20.6 million by 2012.

This is the first time this decade – and indeed since 1994 – where the North American auto sector appears to be going through a cyclical downturn. This decade has seen no growth with sales consistently in the 20 million range,

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North American Sales of Vehicles

-INCLUDES HEAVY DUTY TRUCK

Year	US Total	Canada Total	Mexico Total	North America Total	Canada as a % of N.A.	Mexico as a % of N.A.
2000	17,811,673	1,586,054	902,372	20,300,099	7.8%	4.4%
2001	17,472,378	1,597,875	942,431	20,012,684	8.0%	4.7%
2002	17,138,652	1,731,823	1,003,861	19,874,336	8.7%	5.1%
2003	16,967,442	1,625,050	999,106	19,591,598	8.3%	5.1%
2004	17,298,573	1,574,803	1,119,585	19,992,961	7.9%	5.6%
2005	17,444,329	1,630,142	1,126,778	20,201,249	8.1%	5.6%
2006	17,048,981	1,666,008	1,132,783	19,847,772	8.4%	5.7%
2007	16,460,315	1,690,345	1,093,352	19,244,012	8.8%	5.7%
2007/2006	-3.5%	1.5%	-3.5%	-3.0%		
2008 F	15,900,000	1,642,495	1,050,000	18,592,495	8.8%	5.6%
2009 F	15,500,000	1,629,779	1,100,000	18,229,779	8.9%	6.0%
2010 F	16,400,000	1,639,523	1,250,000	19,289,523	8.5%	6.5%
2011 F	17,000,000	1,651,608	1,350,000	20,001,608	8.3%	6.7%
2012 F	17,500,000	1,658,363	1,450,000	20,608,363	8.0%	7.0%
1990-99	148,782,909	13,022,715	5,498,223	167,303,847	7.8%	3.3%
% Change	9.9%	-2.5%	45.0%	9.7%		
2000-09	169,042,343	16,374,374	10,470,268	195,886,985	8.4%	5.3%
% Change	13.6%	25.7%	90.4%	17.1%		

Source: DesRosiers Automotive Consultants Inc., AIAMC, CVMA and Ward's Automotive Reports

North American Production of Vehicles

-INCLUDES HEAVY DUTY TRUCK

Year	US Total	Canada Total	Mexico Total	Total North America Units	Canada as a % of N.A.	Mexico as a % of N.A.
2000	12,773,714	2,963,097	1,922,889	17,659,700	16.8%	10.9%
2001	11,424,689	2,534,851	1,857,114	15,816,654	16.0%	11.7%
2002	12,279,582	2,633,301	1,804,670	16,717,553	15.8%	10.8%
2003	12,087,028	2,552,862	1,575,447	16,215,337	15.7%	9.7%
2004	11,960,354	2,711,536	1,552,974	16,224,864	16.7%	9.6%
2005	11,946,653	2,687,892	1,684,238	16,318,783	16.5%	10.3%
2006	11,260,277	2,571,366	2,045,518	15,877,161	16.2%	12.9%
2007	10,752,117	2,578,238	2,095,245	15,425,600	16.7%	13.6%
2007/2006	-4.5%	0.3%	2.4%	-2.8%		
2008 F	10,414,115	2,468,257	2,076,763	14,959,135	16.5%	13.9%
2009 F	10,137,612	2,464,107	2,065,582	14,667,301	16.8%	14.1%
2010 F	10,682,604	2,604,111	2,213,945	15,500,660	16.8%	14.3%
2011 F	10,998,963	2,728,989	2,324,923	16,052,875	17.0%	14.5%
2012 F	11,285,461	2,808,270	2,425,504	16,519,235	17.0%	14.7%
1990-99	112,327,093	23,385,315	11,585,525	147,297,933	15.9%	7.9%
% Change	13.4%	40.1%	151.5%	22.4%		
2000-09	115,036,141	26,165,507	18,680,440	159,882,088	16.4%	11.7%
% Change	2.4%	11.9%	61.2%	8.5%		

Source: DesRosiers Automotive Consultants Inc. and Ward's Automotive Reports

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but until 2007 has also seen no appreciable downside. 2007 changed that and with 2008 and 2009 expected to be soft, the auto sector for the first time in over ten years is experiencing a sizeable downturn. Perhaps this is what is behind all the “concerns” we read about in the media. Did a decade-long period of solid sales make us all forget that this is a cyclical industry? Even worse, did we forget how to respond when our industry enters one of its downcycles?

The Canadian market is not expected to sustain losses as significant as those being assessed for the United States. From a high point of 1.69 million units in 2007, Canadian new vehicle sales are expected to decline to 1.629 million in 2009, recovering to 1.658 million units by 2012. Canadian vehicle sales were aided in the second half of 2007 by a strong dollar and the aggressive pricing campaigns waged by many OEMs in reaction to the parity dollar. The Canadian market is certainly not in crisis.

North American production also declined in 2007, but all losses occurred in the United States. While US production fell 4.5 percent from 11.26 million vehicles in 2006 to 10.75 million in 2007, both Canadian and Mexican vehicle producers saw increased volumes (0.3 percent and 2.4 percent respectively). This increase in vehicle production belies all the pundits who insist that Canada is in crisis mode. To have higher production in a year when North American sales are down is a huge achievement for Canada.

The American decline was in-line with the capacity reductions being implemented at GM, Ford, and Chrysler. This is reflected in the fact that combined production at those three manufacturers dropped 5.0 percent in 2007. As a result of the US-based vehicle producers' "right-sizing" in the domestic production market, Canada and Mexico grew their respective production shares to 16.7 percent and 13.6 percent.

For the decade starting in 2000 and ending in 2009, production at GM, Ford, and Chrysler will have fallen a total of 8.6 percent. Conversely, North American import-nameplate production will have grown 74.7 percent during the same period (this follows a massive 297 percent increase during the New Domestics' production build-up during the 1990s).

Canadian production will rise from nearly 2.6 million units in 2007 to upwards of 2.8 million units in 2012. Mexican production will also grow (2.1 million units to 2.4 million units), led primarily by GM, Ford and Chrysler.

North American Production of Vehicles

-INCLUDES HEAVY DUTY TRUCK

YEAR	GM,Ford, Chrysler Units	New Domestic Units
1990-99	115,788,132	28,989,289
% Change	2.4%	297.4%
2000-09	105,796,420	50,654,633
% Change	-8.6%	74.7%

Source: DesRosiers Automotive Consultants Inc. and Ward's Automotive Reports

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North American O.E. and Aftermarket Parts Market

Year	Canada $US billions	U.S. $US billions	Mexico $US billions	Parts Market All N.A. $US billions	% Change
2000	$40.59	$220.46	$28.20	$289.25	-2.1%
2001	$34.93	$207.88	$27.98	$270.79	-6.4%
2002	$34.99	$213.31	$26.15	$274.45	1.4%
2003	$38.60	$237.58	$26.55	$302.73	10.3%
2004	$44.22	$241.39	$27.14	$312.74	3.3%
2005	$46.44	$245.02	$29.92	$321.38	2.8%
2006 E	$47.51	$236.38	$36.50	$320.39	-0.3%
2007 E	$50.79	$228.61	$37.90	$317.30	-1.0%
2007/2006	6.9%	-3.3%	3.8%	-1.0%	

Source: DesRosiers Automotive Consultants Inc. using Industry Data

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The most critical political variable in the automotive equation is employment. With respect to this factor, Canada is not doing as well. Assembly sector employment increased incrementally over 2006, but it is still hovering at a decade low point of 47,500 workers. We are not overly concerned about the decline in assembly employment from its peak since most of these job losses are due to productivity improvements as the OEMs poured billions into refurbishing their plants.

The real story is in the parts manufacturing sector, where employment dropped another 5.3 points in 2007. Over 11,000 jobs have been lost since this beginning of this decade. The parts sector is declining, and that decline is accelerating.

A harbinger of this deterioration is a recent 8.0 percent loss in the Machine, Tool, Die and Mould sector. MTDM employment fell from 27,676 in 2006 to 25,450 in 2007. This represented the first significant drop-off in MTDM employment this decade and signals further trouble in the automotive parts sector (as MTDM products are used in automotive parts production).

While employment drop-off is certainly unfortunate, it is important to note that the parts sector grew rapidly during the 1990s and that a long-due "correction" is now taking place. Rising from 65,000 to nearly 100,000 workers in less than two decades, it is both possible and likely that a mass culling is occurring – those companies that failed to invest are failing en-mass. In this sense, our strong dollar and the negative effects it has on Canada's attractiveness as a production base can be seen as positive for the Canadian auto industry. If this "correction" period results in a stronger, higher-quality production community, existing Canadian players will be better placed to take advantage of future opportunities. It is naturally easier to compete with a weaker dollar, but that weak dollar allowed all kinds of inefficiencies to develop. With a parity dollar, the lake was drained and some jagged rocks were revealed – and these will now be addressed.

Out of all the variables we examine, none is a better indicator of future industrial health than capital investment. Platitudes mean little and promises just slightly more, but actual investment is a measure of a company's faith in a particular production market. With this in mind, Canada is in a fairly healthy place and is most certainly not in crisis. Canada has grown its share of total Canada/U.S. assembly sector investment from 20.8 percent in 2000 to 35.8 percent in 2007. While total industry spend was down, Canada continues to account for a larger percentage of new investments than it has in the recent past.

A similar trend exists in the parts sector, where Canada has managed to increase its share of Canada/U.S. auto parts investments from 6.4 percent in 2000 to 13.6 percent in the most recent year. While total North American investment has fallen precipitously over the past eight years, Canada has maintained and grown its attractiveness as an investment location.

Looking at any one of these industry variables could lead one to form an incorrect conclusion about the state of the North

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American auto sector. When taken as a whole, the latest facts and figures paint a picture of an industry that is indeed entering a cyclical downturn (as it has countless times before), but is well-positioned to ride out the storm and emerge stronger on the other side.

Employment in the Canadian Automotive Manufacturing Sector

Year	Assembly Sector	Percent Change	Parts Sector	Percent Change	Total Automotive Manufacturing	Percent Change	Tool, Die, Mould Sector	Percent Change
1991	53,298		65,416		118,713		17,657	
2000	55,712	-2.1%	98,154	5.3%	153,866	2.5%	26,497	-0.7%
2001	53,205	-4.5%	98,894	0.8%	152,099	-1.1%	25,876	-2.3%
2002	52,038	-2.2%	96,803	-2.1%	148,840	-2.1%	25,971	0.4%
2003	49,971	-4.0%	98,334	1.6%	148,305	-0.4%	27,497	5.9%
2004	50,114	0.3%	97,342	-1.0%	147,456	-0.6%	27,754	0.9%
2005	49,808	-0.6%	96,540	-0.8%	146,347	-0.8%	27,705	-0.2%
2006	47,460	-4.7%	92,315	-4.4%	139,774	-4.5%	27,676	-0.1%
2007	47,544	0.2%	87,417	-5.3%	134,961	-3.4%	25,450	-8.0%

Source: DesRosiers Automotive Consultants Inc. and Statistics Canada SEPH Survey

Why, then, is there this negative pall hanging over the industry and any developments that occur within? The data says that Canada is in a strong position relative to the wider industry – and this is certainly not the first time that dark clouds have gathered in our clear skies – so why are some predicting "the end of the Canadian auto industry?"

Some would say that it's because GM, Ford and Chrysler are troubled, but this argument is easily countered by examining our successes in attracting and retaining New Domestic business. We have several import-nameplate vehicle plants, close to 150 parts suppliers, and 20 percent of annual New Domestic investment spend. These accomplishments offset the downtrending nature of US-based OEMs and suppliers.

Is this simply the 'calm before the storm' or is Canada simply experiencing a crisis of confidence? There's ample reason to believe the former. Our parity dollar has eroded some of our competitive advantage, and the recent UAW contracts have significantly increased the competitiveness of US union labour. Canadian governments no longer subsidize energy costs, so suppliers with energy-intensive products have been struggling. Along with this deterioration in our competitive advantage, it's a fact that numerous scheduled plant closings are known and accounted for, but the effects of their closings do not show up in the 2007 data.

On the other hand, we could simply be experiencing a crisis of confidence. Canada's attitude toward itself has historically been pessimistic. An inferiority streak vis-à-vis the US seems to run through the thoughts of our criers and leaders, and many fail to take into account all the positives that still exist. Despite the fact that our socialized medicine is no longer available as a bargaining tool, Canada still competes – and competes successfully!

If 2007 was indeed the calm before the storm, then we have cause for concern. If, however, the current storm is one of blind fear, then we must dig deep, re-examine the data, and have faith that our auto sector is built of bricks, not straw. DAR

New Capital Expenditures in Canada and the US - $Cdn millions

Assembly Sector

Year	United States	Canada	North America	Canada % of N.A.
2000	$7,096	$1,806	$8,902	20.3%
2001	$6,884	$2,338	$9,221	25.3%
2002	$7,533	$2,206	$9,739	22.6%
2003	$7,244	$2,843	$10,087	28.2%
2004	$6,100	$2,260	$8,360	27.0%
2005	$4,954	$2,327	$7,281	32.0%
2006	$4,310	$3,039	$7,348	41.4%
2007	$3,742	$2,014	$5,756	35.0%

Parts Sector

Year	United States	Canada	North America	Canada % of N.A.
2000	$13,163	$905	$14,068	6.4%
2001	$12,968	$683	$13,651	5.0%
2002	$11,867	$1,097	$12,964	8.5%
2003	$10,396	$1,005	$11,401	8.8%
2004	$8,146	$1,008	$9,155	11.0%
2005	$8,240	$820	$9,060	9.0%
2006	$8,052	$960	$9,012	10.6%
2007	$7,912	$1,202	$9,114	13.2%

Source: DesRosiers Automotive Consultants Inc., Statistics Canada, and the U.S. Census Bureau and U.S. Department of Commerce

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