



# Global Auto Report

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## Used Vehicle Prices Will Remain Under Pressure Across North America — Rising Lease Expiries Lift Supply, While Higher Unemployment Reduces Demand

**V**ehicle sales across North America weakened significantly in March, slumping 11% below a year earlier. The United States accounted for most of the decline, with purchases diving 12% y/y to an annualized 15.1 million units — the lowest level since October 2005, in the aftermath of Hurricane Katrina and down from a full-year 2007 total of 16.1 million units. Volumes were undercut by falling house prices, the ongoing sub-prime mortgage crisis, rising unemployment, record gasoline prices and deteriorating consumer confidence — currently at a five-year low.

Light trucks led the decline, slashing the annualized sales pace of these models to the lowest level since the height of the Asian currency crisis a decade ago. In particular, sales of SUVs plunged 32% below a year earlier, while pickup trucks slumped 23%, with demand sapped by U.S. gasoline prices above \$3.30 per gallon for the first time on record. These two segments now account for less than 25% of overall U.S. new car and light truck purchases, down from nearly 30% a year ago and an average of 36% in the 2001 to 2003 period.

Vehicle sales in **Canada** also fell below a year ago in March, reversing double-digit advances in each of the previous two months. We estimate that purchases softened to an annualized 1.65 million units in March, down from an average of 1.79 million in January and February. As in the United States, the decline was concentrated among light trucks, with SUVs and pickup truck sales leading the fall-off. In particular, GM's high-volume pickup trucks slumped 13% below a year ago.

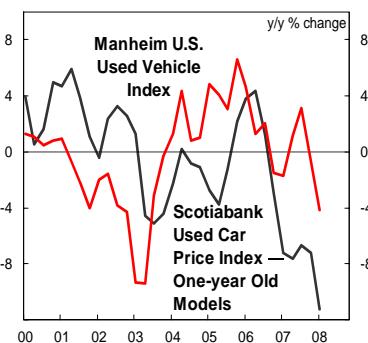
In contrast, the popularity of crossover utility vehicles (CUVs) continues to surge, with purchases in Canada soaring nearly 30% y/y in the first quarter of 2008. These vehicles now account for 20% of total new vehicle sales in Canada — double their share as recently as 2004, and second only to small cars, a segment that garners more than one-third of the Canadian market. In fact, CUVs have become so popular across North America, that Ford is hiring an additional 500 workers at its plant in Oakville, Ontario — the production site of the Ford Edge and the Lincoln MKX crossover utility vehicles.

### **SLIDE IN USED VEHICLE PRICES WILL CONTINUE THROUGH EARLY 2009**

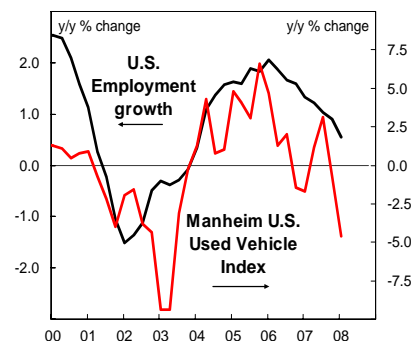
Used car prices have been declining across North America since late 2006, but the weakness accelerated in early 2008 alongside deteriorating economic conditions — especially in the United States. We expect used car prices to continue to soften through the first half of 2009, pressured by rising unemployment in both the United States and Canada.

The weakness in pre-owned vehicle prices began in Canada, with rising imports of secondhand models from the United States undercutting pricing for pre-owned vehicles. However, the decline has spread south of the border, as

**Used Car Prices Are Under Pressure**



**Employment & Car Prices**



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slowing U.S. economic growth and rising energy and food costs have dampened U.S. household purchasing power.

The Scotiabank Used Car Price Index — which tracks prices in Canada's pre-owned vehicle market — began to weaken in mid-2006, with the decline accelerating in recent months. In the first quarter of 2008, the index dropped 7% below a year ago, led by an 11% slump in the price of one-year old models — the weakest performance on record for data back to 1978. The sharp drop in one-year old vehicle prices reflects a lowering of new car prices in Canada — especially by foreign automakers — to bring them more in line with pricing in the United States. (Statistics Canada indicates that purchasing or leasing a new vehicle was 7% less expensive last month than a year earlier.) A 145% surge in used vehicle imports into Canada from the United States has also pressured prices in Canada. Data from the Registrar of Imported Vehicles indicate that Canadian households and dealers imported a record 64,082 vehicles in the first quarter — a level matching the full-year 2004 total.

A record number of vehicles coming off-lease in Canada is also dampening used car prices. We estimate that more than 550,000 cars and light truck leases will expire in Canada this year, adding to the glut of more than 200,000 used vehicles that will be imported from the United States. This sharp increase in supply is already undercutting residual values, forcing automakers and auto finance companies to take steep losses. For example, a major U.S. automaker indicated that a record 86% of all vehicles coming off-lease in North America are being returned to the manufacturer, forcing the company to incur losses of more than US\$8,000 for each vehicle it repossesses — a level significantly higher than losses incurred five years ago, when residuals were also facing significant pressure.

In the United States, Manheim Consulting indicates that used vehicle prices have been softening since November 2007 and were down nearly 6% y/y in March. The decline reflects slower economic growth — especially declining employment, which has fallen for three consecutive months, undercutting demand for both new and used vehicles. New vehicle sales are being impacted most, with U.S. retail purchases slumping 11% y/y in the first quarter. However, while used vehicle sales have been more resilient, volumes have also weakened, and prices are being pressured by additional vehicles coming off-lease in the United States. Estimates suggest that roughly 2.7 million car & light truck leases will expire in the United States this year, up from 2.3 million in 2006.

The ongoing credit crunch is also cutting into vehicle demand by reducing not only the number of auto loans, but also the loan value and the length of term. Furthermore, loan spreads above prime have tripled compared to recent years, as the market is re-pricing risk. Banks in the United States have also tightened credit standards and are de-leveraging their balance sheets. For instance, repossessions are being accelerated, and they are dealing with potential problems now, rather than later. These factors will deepen the cyclical decline in vehicle sales and pricing, but will set the stage for a recovery in 2009.

In fact, early long-term leading indicators of economic activity — such as the slope of the yield curve — have started to improve in both Canada and the United States. However, changes in the slope of the yield curve lead both employment growth and vehicle pricing by about seven quarters, suggesting that a bottom in vehicle prices is unlikely until early 2009.

### International Car Sales Outlook

	<u>1990-99</u>	<u>Peak 2000</u>	<u>2001-04</u>	<u>2005-06</u>	<u>2007</u>	<u>2008f</u>
			<i>(millions of units)</i>			
<b>TOTAL SALES</b>	<b>39.20</b>	<b>46.64</b>	<b>47.02</b>	<b>51.75</b>	<b>54.76</b>	<b>55.34</b>
<b>North America*</b>	<b>16.36</b>	<b>19.77</b>	<b>19.44</b>	<b>19.45</b>	<b>18.83</b>	<b>17.71</b>
Canada	1.27	1.55	1.60	1.60	1.65	1.61
United States	14.55	17.35	16.85	16.72	16.09	15.00
Mexico	0.54	0.87	0.99	1.13	1.09	1.10
<b>Western Europe</b>	<b>13.11</b>	<b>14.75</b>	<b>14.49</b>	<b>14.65</b>	<b>14.75</b>	<b>14.60</b>
Germany	3.57	3.38	3.27	3.41	3.15	3.18
<b>Eastern Europe</b>	<b>1.18</b>	<b>2.38</b>	<b>2.13</b>	<b>2.80</b>	<b>3.58</b>	<b>3.91</b>
Russia	0.78	1.03	1.09	1.42	2.31	2.54
<b>Asia</b>	<b>6.91</b>	<b>7.85</b>	<b>9.14</b>	<b>12.33</b>	<b>14.29</b>	<b>15.22</b>
China	0.33	0.61	1.55	3.68	5.15	5.92
India	0.31	0.60	0.66	0.94	1.18	1.30
<b>South America</b>	<b>1.64</b>	<b>1.89</b>	<b>1.82</b>	<b>2.52</b>	<b>3.31</b>	<b>3.90</b>
Brazil	0.94	1.17	1.22	1.46	1.98	2.33

\*Includes light trucks.

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