ECONOMIC VIEWPOINT

Canada: Many Detours Ahead for the Auto Industry

The Canadian auto industry is an integral part of North American production and is largely dependent on U.S. demand. The recent slowdown in car sales south of the border is worrisome, and the challenges of remaining competitive are still significant in light of lively foreign competition. Although recent investments in the Canadian auto industry point to a few more years of security, what will happen in future decades?

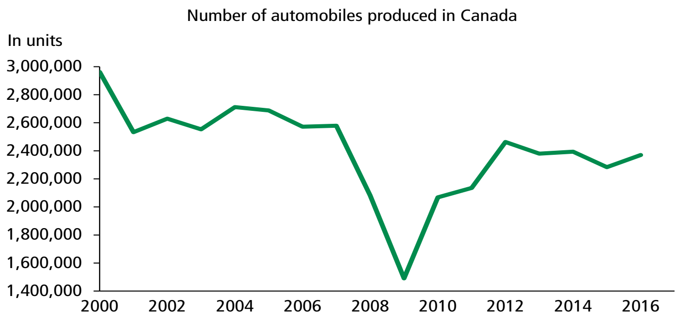
In our *Economic Viewpoint* on the U.S. auto market, published April 20, we concluded that the strong growth of auto sales recorded in the United States in recent years has lost steam in recent months. This slowdown could have significant impacts not only south of the border but also in Canada, since the industry is so interconnected.

Integration Goes Back a Long Way

Canadian auto production has been intimately linked to the U.S. industry from the earliest days of the automobile. It began with the Ford Motor Company of Canada in 1904, just one year after Henry Ford started manufacturing cars in Detroit. After several decades of growth, the 1965 Auto Pact led to the complete abolition of customs tariffs on cars and auto parts traded between Canada and the United States. Needless to say, that agreement consolidated the integration of the auto industry between the two countries. It was followed by the 1989 Canada-U.S. Free Trade Agreement and then the 1994 North American Free Trade Agreement (NAFTA), which included Mexico. Automobiles and the parts needed to manufacture and repair them have been circulating freely between Canada and the United States for just over 50 years.

Free trade was very beneficial to the Canadian auto industry, which still affects the economy as a whole very significantly, directly or indirectly. But we do have to admit that the past few years have been more difficult for the Canadian auto industry. There was certainly negative fallout from the crisis that shook the sector during the 2008–2009 recession, including the bankruptcies of two large manufacturers. The impact of greater market globalization has to be factored in too. Even though the number of automobiles manufactured in Canada has risen from its cyclical low in 2009, production still has not reached the level recorded at the beginning of the millennium (graph 1).

GRAPH 1
Canadian automobile production has still not returned to pre-crisis levels



Sources: International Organization of Motor Vehicle Manufacturers and Desjardins, Economic Studies

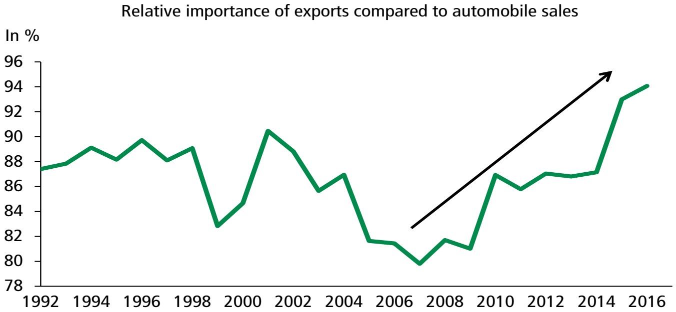
The Canadian Industry Is Up Against Stiff Competition

These difficulties have arisen while the Canadian auto industry has become increasingly dependent on foreign demand in recent years. The proportion of motor vehicule sales by Canadian manufacturers destined for export increased from 79.8% in 2007 to 94.1% in 2016 (graph 2 on page 2). So the recent tapering off of U.S. demand is particularly worrisome and leads to fears that Canadian automobile production will also slow down in the coming months.

Another difficulty for Canadian manufacturers stems from the ever-greater competition farther south. While the number of manufacturing plants in Canada has not changed in recent years, Mexico has attracted several new plants because wages there are lower than in Canada or the United States. That has greatly increased Mexico's production capacity. The number of automobiles produced in Mexico went from 1.9 million

François Dupuis, Vice-President and Chief Economist • Benoit P. Durocher, Senior Economist
Desjardins, Economic Studies: 514-281-2336 or 1 866-866-7000, ext. 5552336 • desjardins.economics@desjardins.com • desjardins.com/economics

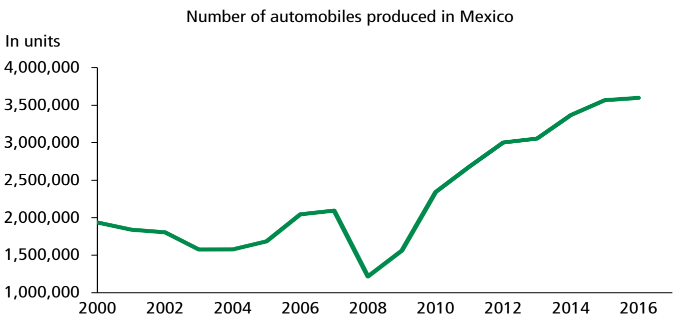
GRAPH 2
The Canadian auto industry's dependence on foreign demand has increased



Sources: Statistics Canada and Desjardins, Economic Studies

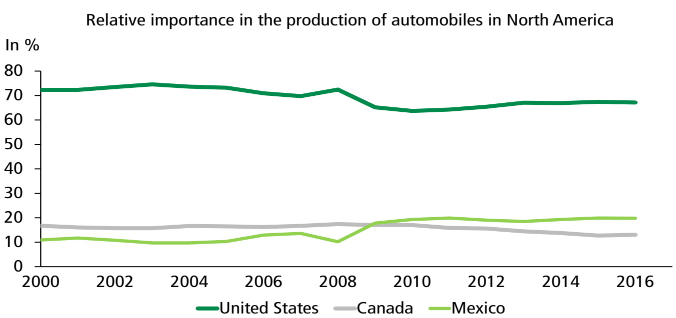
in 2000—lower than the number in Canada—to 3.6 million in 2016 (graph 3), overtaking Canada, which has never gone over the 2.5 million vehicles it produced in recent years. Mexico's relative importance in North American auto manufacturing was achieved to the detriment of both Canada and the United States (graph 4).

GRAPH 3
Mexican automobile production has increased significantly in recent years



Sources: International Organization of Motor Vehicle Manufacturers and Desjardins, Economic Studies

GRAPH 4
Mexico's automobile production overtakes Canada's

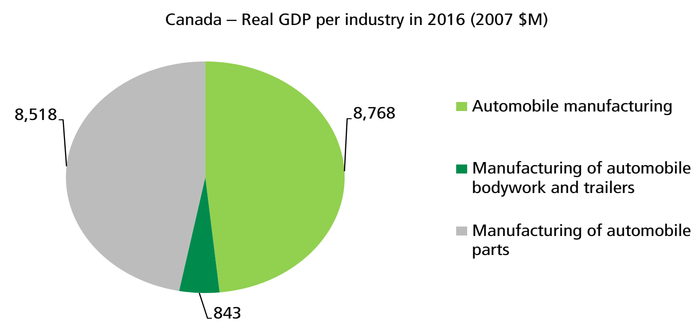


Sources: International Organization of Motor Vehicle Manufacturers and Desjardins, Economic Studies

These significant competitive disparities underlie concerns about surging U.S. protectionism and the future of NAFTA. Therefore, the future of the Canadian auto industry seems very unsure. The long history of free trade in the Canadian and U.S. auto industry should preserve some privileges of Canadian manufacturers, but Canada may not be able to develop new production capacities and capture a larger market share.

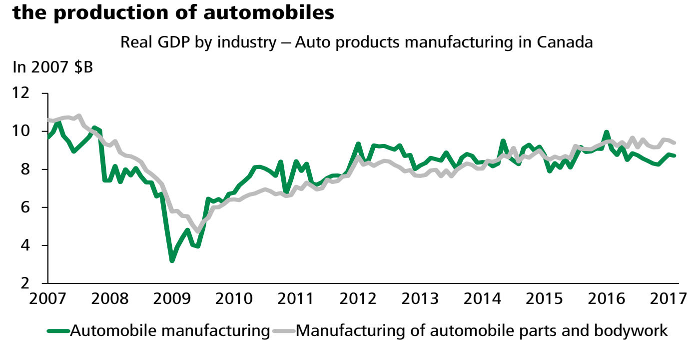
That being said, automobile manufacturing is only part of the Canadian auto industry. Canada is currently home to several auto parts or body panel factories that feed auto production both at home and abroad, particularly in the United States and Mexico. Parts and body panels made up just over half the production volume of the auto industry in 2016 (graph 5). Not surprisingly, the growth of parts and panels correlates strongly with the production of whole cars. So the production volume of auto parts and panels has also remained fairly stable for some years, while still below the level recorded at the beginning of the millennium (graph 6).

GRAPH 5
Parts manufacturing is also very important for the auto industry



Sources: Statistics Canada and Desjardins, Economic Studies

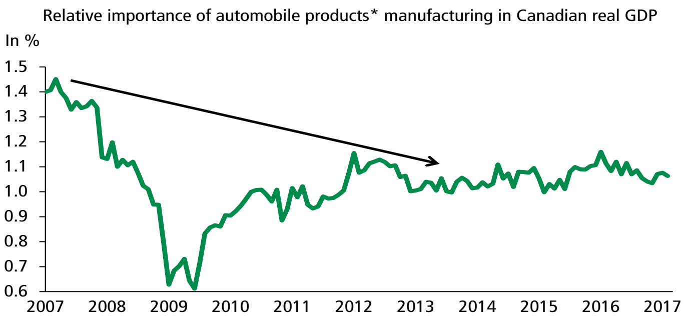
GRAPH 6
The manufacturing of parts and bodywork correlates strongly to the production of automobiles



Sources: Statistics Canada and Desjardins, Economic Studies

As a whole, the influence of the auto industry on the Canadian economy has been losing ground for some 15 years. The relative importance of the auto industry in Canadian production (excluding indirect effects) went from 1.4% at the beginning of 2007 to less than 1.1% in 2017 (graph 7).

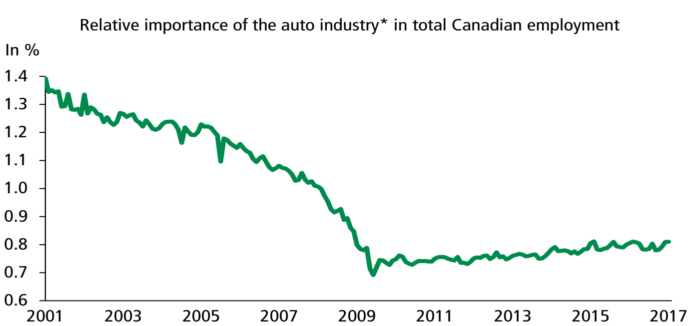
GRAPH 7
The Canadian economy's dependence on the auto industry has dwindled



* Vehicles, parts and bodywork items.
Sources: Statistics Canada and Desjardins, Economic Studies

The same is true of the number of jobs in the auto industry. While 175,000 direct jobs were reported in the sector at the start of 2001, the 2008–2009 crisis reduced the number of workers to only 102,896 in June 2009. The subsequent recovery led to some job growth in the industry but, with just under 130,000 direct jobs at the start of 2017, the industry was still about 45,000 jobs shy of the 2001 number. The relative importance of the auto industry with respect to total employment is still very weak compared to the levels at the beginning of the millennium (graph 8). Nevertheless, job recovery in the auto industry was far less pronounced than production recovery. Since the cyclical low of 2009, the auto industry's production volume doubled with an increase of 109%, whereas the number of jobs in that industry went up only 24% since the low in 2009. Assuming that the average number of hours worked by each worker did not change between those two time periods,[1] worker productivity seems to have improved significantly in the Canadian auto industry. This is good news for the competitive position of Canadian companies in light of the strong foreign competition.

GRAPH 8
Employment in the auto industry is still sluggish

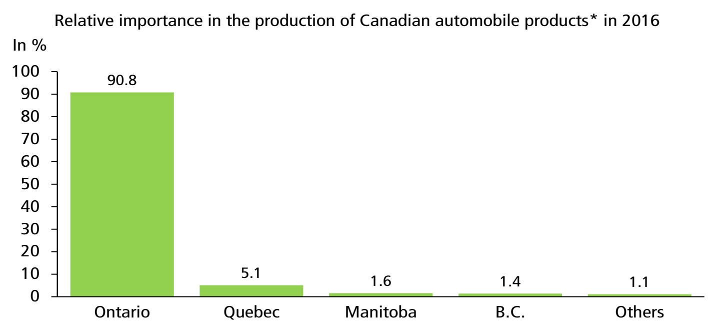


* Vehicles, parts and bodywork items.
Sources: Statistics Canada and Desjardins, Economic Studies

An Industry That Is Mainly Concentrated in Ontario

Ontario is home to most of Canada's auto industry due to its geographic proximity to the large U.S. manufacturing centres. Some manufacturers of truck, bus or parts are operating in other provinces, but Ontario hosts the industry's main plants.[2] In 2016, Ontario represented over 90% of the entire Canadian production of automobile products (graph 9). Automobile and auto part manufacturing accounts for close to 2.5% of Ontario's real GDP, compared to only 1% for Canada as a whole. It goes without saying that the auto industry is the largest manufacturing sector in Ontario, and the auto industry greatly influences that province's international trade. Despite the difficulties of recent years, the automobile, auto parts and body panel manufacturing sectors accounted for over 30% of all Ontario goods exports in 2016 (graph 10 on page 4). By way of comparison, the relative importance of those sectors in goods exports of the other provinces was only 2%.

GRAPH 9
The Canadian auto industry is mainly concentrated in Ontario



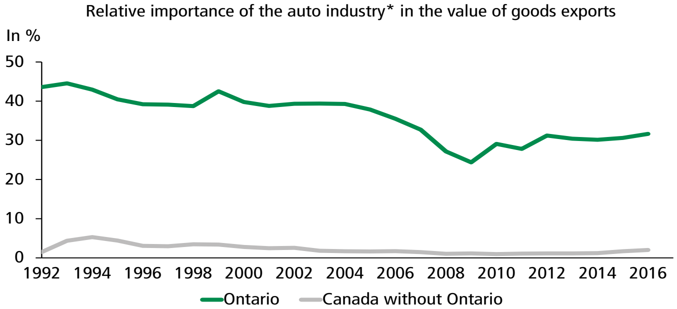
* Vehicles, parts and bodywork items.
Sources: Statistics Canada and Desjardins, Economic Studies

The main destination for Ontario automobile product exports is obviously the United States. Just over half of Ontario's automobile exports went to the state of Michigan (57%), followed by California (32%), Ohio (2%) and Indiana (2%). Conversely, the main sources of Ontario automobile imports

[1] In reality, the number of hours worked by each worker may have even gone down a bit, which would push the lever even higher in favour of productivity. Based on incomplete figures from Statistics Canada, hourly-paid workers in the auto industry worked an average of 39.6 hours a week in 2009 (including overtime), compared with 38.3 in 2016.

[2] Fiat Chrysler, Ford, General Motors, Honda and Toyota all have automobile assembly plants in Ontario.

GRAPH 10
The auto industry accounts for a significant portion of Ontario's international trade



* Vehicles, parts and bodywork items.
Sources: Statistics Canada and Desjardins, Economic Studies

from the United States were Michigan (30%), Ohio (13%), Indiana (11%) and Kentucky (8%).

An Uncertain Future…

Even though its relative weight has gone down a bit in recent years, the auto industry is still an important factor in the Canadian economy, particularly Ontario's economy. There are many challenges ahead. Not only will North American demand slow down in the coming months, but the competitive context will be extremely demanding; this may put several of our manufacturing plants in jeopardy. Coupled with this, the uncertain future of NAFTA is unsettling, although most people believe there will still be some sort of free trade—at least in the auto industry—because trade between Canada and the United States is so interconnected.

And yet, several investments have been announced recently, particularly in the Ford plant in Windsor and the GM factories in Oshawa and St. Catharines; that may save the day for a while longer. But what will happen a few decades from now? How greatly will technological changes affect the auto industry in coming years, and how will Canada cope? So many questions, so little certainty.

Benoit P. Durocher, Senior Economist