TD Bank Financial Group

TD Economics

Special Report

January 25, 2007

PROSPECTS FOR CANADA'S AUTO AND PARTS SECTOR

Engine to sputter, but not breakdown in 2007

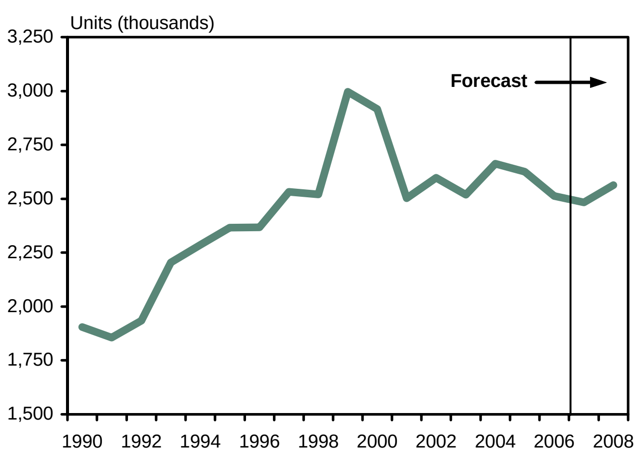
Canada's auto sector has entered 2007 battling a number of headwinds, notably declining North American light vehicle sales and the restructuring efforts of the U.S.-headquartered Big Three of General Motors, Ford and DaimlerChrysler. Although rising Canadian production from other manufacturers – notably Toyota and Honda – is taking up some of the slack, even those companies will not be immune to the drop in continent-wide sales expected this year.

While the challenges facing many auto and parts producers will remain formidable, the overall story is far from a gloomy one. Not only are auto purchases less prone to sharp downswings than in the past, but the U.S. sales picture is expected to brighten later this year. In 2008, the start-up of Toyota's assembly plant at Woodstock will provide an added fillip to production, helping to counter the drag exerted by further actions by the Big Three to better align production with market share.

HIGHLIGHTS

- **North American light vehicle sales to head lower for a second straight year in 2007**
- **Canadian output of autos and light trucks to decline by 1.2% in 2007, compared to a projected 2.6% drop in the United States**
- **Start-up of Toyota plant in Woodstock to drive up total Canadian output by 2% in 2008**
- **Canadian parts industry facing tougher times as it also confronts competitive pressures from China**
- **Parts output to pull back by 6% this year and to recoup only part of that loss in 2008**

CANADIAN LIGHT VEHICLE PRODUCTION



Source: WardsAuto.com; Forecast by TD Economics as at Jan. 2007

The $1.1 billion Toyota investment – which alone is slated to add some 150,000 vehicles (1% of total Canadian assembly capacity) and 2,000 jobs to the national count next year – represents part of the roughly $7 billion in new auto and parts capital spending commitments announced over the past few years that have been partly supported by provincial and federal funding. These investments have helped to ease concerns about the longer-term sustainability of the country's auto industry.

Among the risks facing TD Economics' 2007-08 output projections, the most notable relates to the success of the Big Three in marketing new vehicle models, winning over consumers and, hence, elevating their bottom lines. To the extent that these companies continue to see their market shares dwindle vis-à-vis foreign brands, further downsizing announcements would likely be required, placing a downside risk on our auto production outlook. In this event, the auto parts industry – which is heavily leveraged to the Big Three – would be dealt yet another setback as it confronts growing competition from China and other emerging markets. At the same time, the closure of Big Three facilities could create some offsetting opportunities for domestic parts makers that operate in the same lines of business.

2006 North American sales of more than 19 million units

On the heels of healthy increases in the prior two years, sales of light vehicles in North America fell back by an estimated 1.7% in 2006, as a decline in U.S. sales was partly offset by increases recorded in both Canada and Mexico. Nevertheless, the outcome was hardly a disaster, as the level of North American sales managed to hold at a relatively elevated level of more than 19 million vehicles. Indeed, since the late 1990s, light vehicle sales have remained relatively stable – in sharp contrast to the prior decade, when annual swings of 7-10% weren't uncommon. This more stable sales profile is partly related to less volatile trends in inflation and interest rates across North America.

U.S. sales to begin a modest recovery later this year

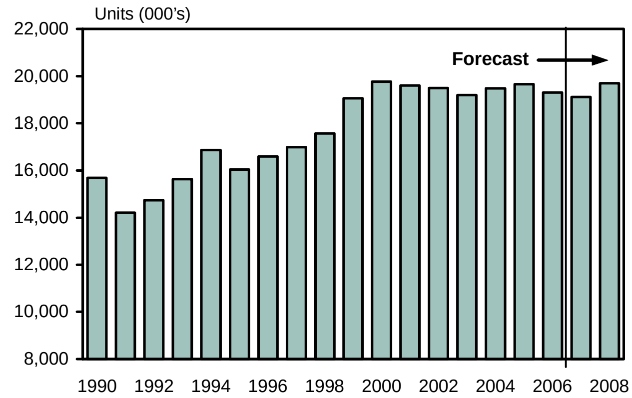
Last year, the negative impact on wealth from a cooling off in the U.S. housing market and the knock-on effects of interest rate increases put in place by the Federal Reserve put a moderate damper on U.S. auto sales. Furthermore, prices at the pump jumped for the fourth straight year, taking a further bite out of affordability. And while sales incentive programs offered by manufacturers remained generous, the average incentive offered by the Big Three in November 2006 (US$2,237 per vehicle) was 7% lower than a year earlier. Foreign-based manufacturers, which provide smaller incentives on average than the U.S. companies, also whittled back their incentives on a year-over-year basis.

Looking ahead to 2007, the dramatic drop in gasoline prices registered since last autumn has – at least temporarily – removed one of the impediments in the way of auto purchases. In addition, U.S. employment data for December revealed that both job creation and personal income growth ended last year on a high note. But while these factors should preclude a major retrenchment in sales going forward, we believe that consumers Stateside will become more cautious over the next few quarters as they attempt to replenish their low savings amid declining home prices and slowing growth in household net wealth. After two consecutive annual declines, we forecast U.S. light vehicle sales to grind higher in 2008, but remain some 5% below their 2000 peak.

Little pent-up demand for light vehicles in Canada

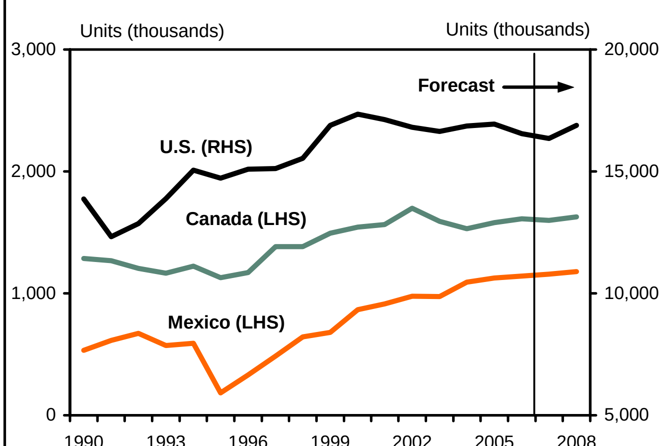
In Canada, the growth in light vehicle sales in 2006 largely reflected strength in the western markets, where high resource prices spurred strong consumer spending growth. In contrast, consumers in the weaker economies of central and eastern Canada purchased fewer vehicles,

NORTH AMERICAN LIGHT VEHICLE SALES



Source: WardsAuto.com; Forecast by TD Economics as at Jan. 2007

NORTH AMERICAN AUTO SALES BY COUNTRY

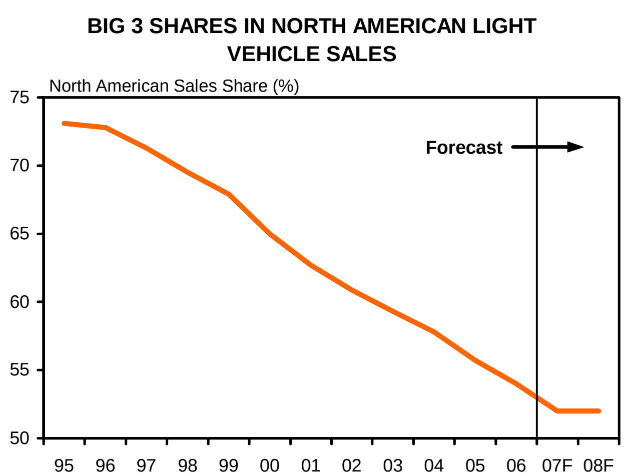


Source: WardsAuto.com; Forecast by TD Economics as at Jan. 2007 thus constraining the national auto sales growth rate to one half of that recorded in 2005. Still, at 1.6 million units sold, last year marked the second best year on record after 2002, while gains in vehicles per household over the past decade have far outstripped that south of the border.

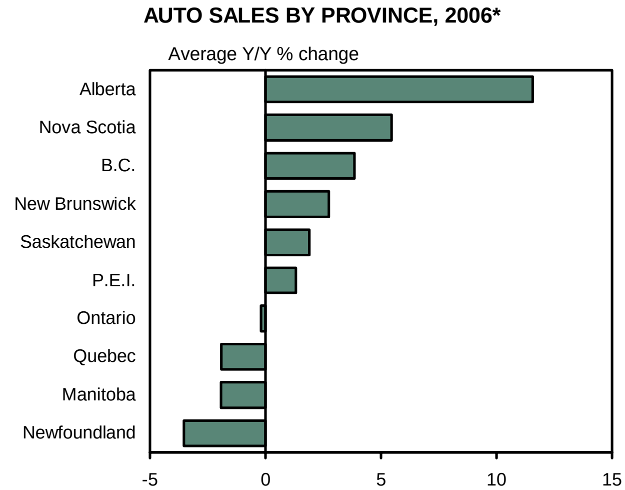
With even less pent-up demand in Canada than in the United States, there is good reason to believe that Canadian sales will under-perform the North American average in 2007 and 2008. Although the Canadian unemployment rate is expected to hold at close to a 30-year low over the next few years, gains in employment and personal income are expected to slow considerably from last year's solid pace. In addition, sales are projected to cool in western markets, as a likely pull-back in commodity prices on an annual average basis in 2007 puts a damper on some of the recent buying enthusiasm.

Sales in Mexico to grow moderately

In Mexico, brisk growth in the economy – combined with a relatively low average vehicle ownership rate and a large pool of new potential buyers – continued to provide support to vehicle demand last year. Nonetheless, the estimated growth in auto sales still slipped to its lowest rate in a decade, suggesting that some maturation in the market has begun to take root. Moreover, in the short run, Mexico's economic performance will continue to be dampened by lacklustre import demand from the United States, its number-one trading partner. Hence, while we expect further gains in auto sales in this developing market, growth is projected to remain relatively muted and well below its recent breakneck clip.



Forecast by TD Economics as at January 2007
Source: Statistics Canada/Haver Analytics



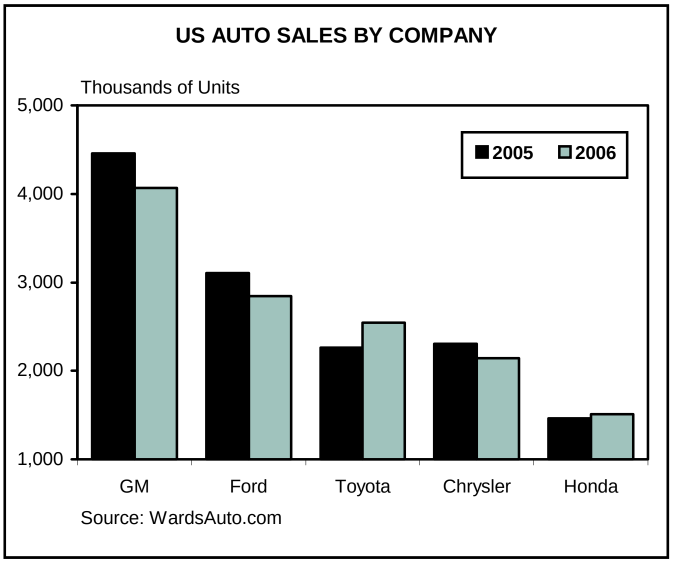
*To November 2006; Source: Statistics Canada/Haver Analytics

Big 3 market share continues to sag in 2006

With the U.S. and overall North American sales climate likely to weaken further before it gets better, the key question weighing on the minds of many Canadians is whether the Big Three will be able to turn around their declining tide of sales in North America. In 2006, the Big Three all witnessed major slippages in continent-wide sales – even DaimlerChrysler, which had been the only one of the three to see market share gains in 2004 and 2005. And with most foreign-based manufacturers enjoying another year of strong sales in 2006, the Big Three's share of the North American market dropped to 53%, well below the level of more than 70% registered as recently as 1995.

Over the past decade, the falling share of Big Three sales has largely been concentrated in the car market, as foreign brands have been perceived to be superior in terms of both model design and quality. Meanwhile, the U.S.-based companies have retained a comparative advantage in light truck sales, but even there, the edge has begun to erode. In 2006, a further blow was delivered to the Big Three, when a spike in gasoline prices sent consumers scurrying away from SUVs and mini-vans towards smaller, more energy-efficient cross-over utility vehicles (CUVs) and hybrids. This shift in taste brought the combined U.S. inventories of the Big Three to 75 days by the end of 2006, compared to the industry norm of 70 days.

With a double-digit gain in sales in 2006, Toyota has catapulted above DaimlerChrysler as the number three seller in the United States and is now only slightly behind Ford for number two spot. In Canada, only General Mo-



tors suffered a pull-back in sales in 2006, while Toyota posted the strongest gain. Owing to brisk sales of its Fusion and Focus models, Ford enjoyed a sold showing in Canada last year, leaping above DaimlerChrysler into second place on the sales charts. In terms of the 2006 Canadian market share, General Motors remained on top (26.0%), followed by Ford (14.9%), DaimlerChrysler (14.8%) and Toyota (12.1%).

Big 3 restructuring key development of 2006

The continued decline in North American market share and relentless pressure on financial positions has cast the spotlight on the announced restructurings of the U.S.-headquartered automakers. The overriding objective of these reorganizations is to improve product mix and marketing strategy, bring production in North America more into line with market share, increase focus on the fast-growing global markets, reduce structural operating costs and cut legacy costs including those related to health care. There has also been some chatter about the possibility of strategic alliances being struck up with foreign-based producers (i.e., Ford and Toyota) in order to raise efficiency.

- General Motors was the first out of the gate, by announcing a 3-year North American restructuring plan in November 2005 that included the closure of 9 assembly plants and parts facilities across the continent and the elimination of more than 20% of its workforce (i.e., 30,000 jobs) by 2008. The company has targeted a $7-billion reduction in structural expenditures by the end of the current fiscal year and is aiming to slash its global cost base from 34% of automotive revenue currently to 25% by 2010.
- In September 2006, Ford indicated that it was accelerating its multi-year restructuring plan first announced earlier last year in order to deliver faster progress through 2008. In total, 14 North American facilities will be idled and cease production through 2012, representing about 25% of its manufacturing capacity. In addition to its target to cut its North American salaried workforce by 14,000 by 2007, Ford is aiming to reduce its hourly workforce by 25,000-30,000 by 2012. How-

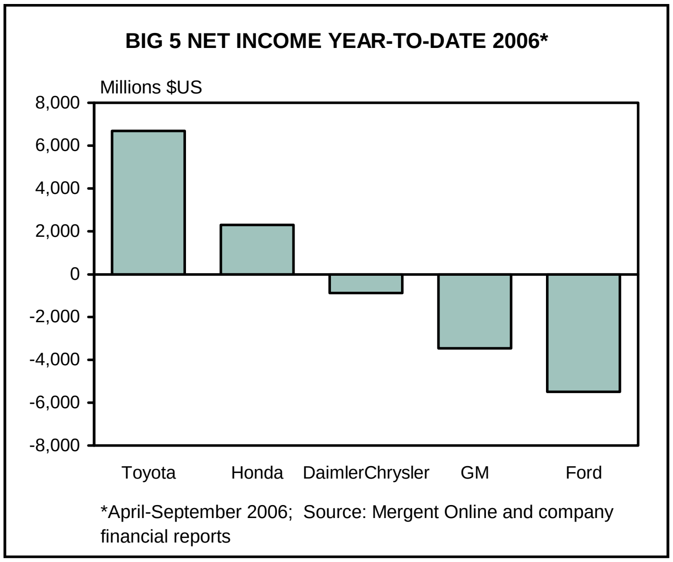
Closure of North American Facilities Announced by GM and Ford

General Motors

- Oklahoma City, Okla. assembly plant (early 2006)
- Lansing, Michigan assembly plant (mid-2006)
- Spring Hill, Tenn., Plant/Line #1 (end of 2006)
- Doraville, Ga. assembly plant (2008).
- Oshawa assembly plant #1 (late 2006)
- Moraine, Ohio assembly plant, third shift (2006)
- Lansing, Michigan metal centre (2006)
- Pittsburgh, Pa. metal centre (2007)
- Portland Ore. parts distribution centre (2006)
- St. Louis Mo. warehouse to be converted to collision (2006)
- Ypsilanti, Mich. parts processing centre (2007)
- St. Catherines, Ont. powertrain componenets facility (2008)
- Flint, Michigan engine facility (2008)

Ford

- Atlanta, Ga. assembly plant (October 2006)
- Batavia, Ohio transmission facility (2008)
- Windsor, Ontario Essex engine plant (2007)
- Maumee, Ohio stamping facility (2008)
- Norfolk, Virginia assembly plant (2007)
- St. Louis, Missouri assembly plant (March 2006)
- Twin Cities assembly plant, Minnesota (2008)
- Windsor, Ontario castings plant (2007)
- Wixom, Michigan assembly plant (2007)
- All ACH operations to be sold or closed by 2008
- Additional, yet-to-be-named facilities, bringing total closures to 16 by 2012



ever, some 38,000 hourly workers have agreed to accept early retirement and buyout packages. The company's goal is to restore profitability by 2009 partly on the back of a $5 billion cut in its annual operating costs.

- DaimlerChrysler plans to release a restructuring plan when it brings down its 2006 earnings in February 2007. While the restructuring is unlikely to be as drastic as that implemented by the company in 2001, when it slashed its workforce by 20% (i.e., 40,000 employees), it will likely include up to two plant closures and significant job reductions.

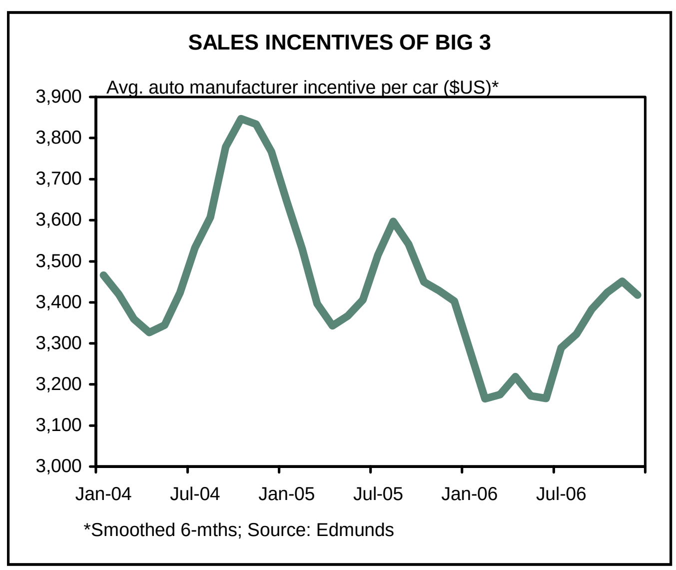
Although the jury remains out on how successful the Big Three will be in achieving these goals, we are optimistic that these moves will pay off in terms of stemming their trend decline in market share and raising their long-term viability. The new line-ups planned over the next few years will feature a number of stylish, more fuel-efficient models and an increased offering of hybrids. For example, the Ford Edge, Chevrolet Malibu, Dodge Caliber and Ford Focus are among a number of new models or concepts that have generated interest, while General Motors created some buzz at the recent North American International Auto Show by unveiling an electric concept car called the Volt. At the auto show, the Saturn Aura sedan and Chevrolet Silverado were named North American car and truck of the year, respectively. These moves appear to mark a good step forward, although more will need to be done.

In addition to a solid product mix, the Big Three companies are attacking the perception issue in other ways. As we've noted, weak perception has been reinforced by the fact they offer large incentives (i.e, discounts), which hurts brand image and the trade-in values. Moreover, these two companies' large sales to car rentals and taxi fleets have also impaired the quality image of their product. The restructurings announced by GM and Ford include a commitment to cut back on sales in these areas.

A development step in moving the Big Three forward in their recovery plan will be the upcoming negotiations with the UAW in connection with the expiry of the existing three-year labour contract in September 2007 (Canadian industry agreements don't expire until 2008). These negotiations are almost certain to be difficult in view of the companies' desire to secure further cost savings, including those related to past benefit guarantees.

Smaller impact on Canadian operations

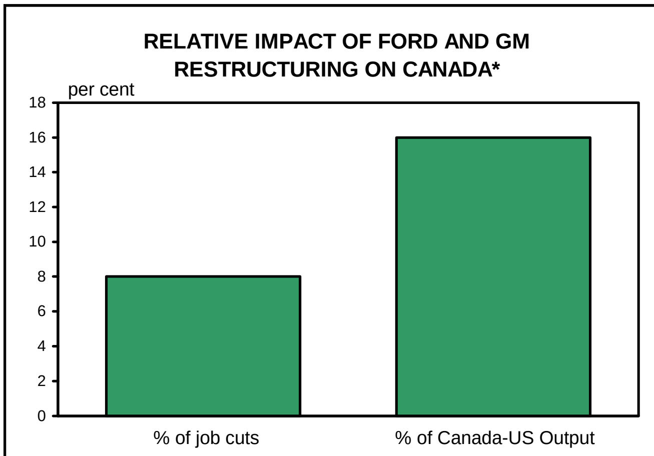
The impact of these restructurings on TD Economics' North American production outlook is significant. Although a sizeable share of the planned General Motors' facility closures has already been implemented across the continent, the impact of the Ford plan will start to hit in earnest in 2007. In addition, the yet-to-be-launched restructuring of DaimlerChrysler – while likely to be significantly smaller than its counterparts – is still in the pipeline. As a result, the Big Three is almost certain to see its North American production share continue to decline sharply in 2007 and 2008. Meanwhile, Toyota is revving up its expansion plans with a goal of becoming the largest



automaker in the world – and the second largest in North America – as early as 2007.

A fact that resonates from topic box on page 4 is that a disproportionate share of the downsizing has been targeted at U.S. operations. In contrast, cuts to Canadian capacity – while still not without inflicting pain and hardship – have been less severe. For example, among the layoffs of roughly 70,000 announced by Ford and General Motors so far, fewer than 6,000 (or about 8% of the total) are slated for Canada. In comparision, this country accounts for about 16% of these companies' combined Canada-U.S. production. And since the restructuring plans were announced, General Motors indicated that it would keep one of the two Oshawa plants (#2) running beyond 2008 by awarding the facility the job of building the redesigned Chevrolet Camaro. No doubt, the magnitude of cuts by Ford and General Motors will ultimately be tied to sales – and overall company profit – performances going forward. Still, these recent developments have helped to cushion some of the blow.

This vote of confidence in Canada's auto infrastructure by the Big Three producers builds on other "good news" announcements over the past few years. For example, among $7 billion in new investment commitments within the Canadian auto industry (see text box below) include a $2.5 GM Beacon Project, $1 billion at Ford's Oakville complex and about $800 million by DaimlerChrysler in flexible manufacturing enhancements at its Windsor operation. These investments also earmark amounts toward research activities.



*combined job cuts by Ford and GM in Canada as % of total cuts vis-à-vis their share of Cdn production; Source: Ford & GM restructuring plans, TD Economics

In addition to financial support being provided under the Ontario government's automotive strategy, other fac-

$7 Billion in New Investment Driven by a Solid Strategy

Over the past few years, a total of $7 billion in auto investments has been announced in Ontario. These include:

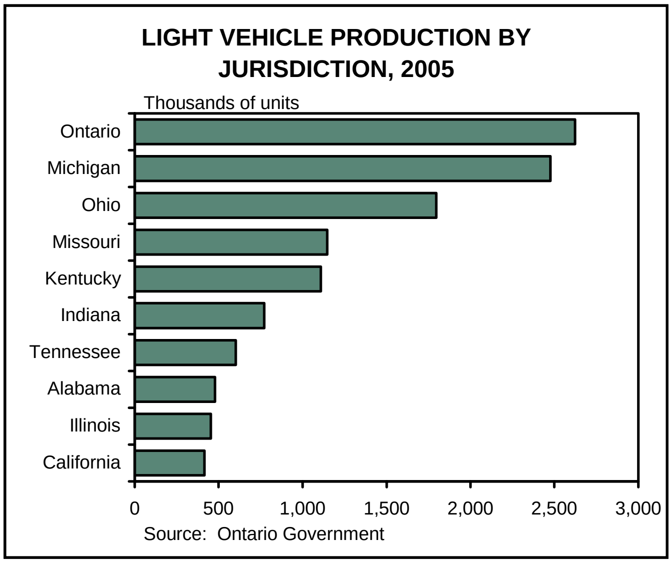
- General Motors $2.5 billion Beacon Project that supports vehicle design and manufacturing capabilities at plants in Oshawa, St. Catherines and Ingersoll;
- Ford's $1.1 billion project to create a flexible manufacturing facility in Oakville and for a new research and development centre focused on fuel cell technology;
- $1.1 billion committed by Linamar Corporation partly to create a Technology Centre at its Guelph operations;
- Toyota's $1.1 billion investment in an new greenfield's assembly plant at Woodstock;
- $768 million committed by DaimlerChrysler to put in place new technologies at the Windsor Assembly Plant and invest in its Brampton operations; $270 million to be invested by Navistar at its Chatham and Windsor facilities;
- Honda will allocate $154 million to its operations in Alliston.

As we discuss on page 6-7, these investments have been partly owing to Ontario's favourable business climate. They have also been driven by the moves by the governments to join the incentive game that has been played out in many U.S. states in attracting investment. For instance, in addition to federal support, the $7 billion in new funds committed has been leveraged by roughly $500-600 million in provincial funding. Above all, the strategy is being carried out in a well-thought-out way. An important component of the new grants provided under Ontario's automotive strategy is the development of research activities. Success in spurring research and climbing the value-added curve will be vital for fighting off competition from China and other developing market players down the road.

tors are helping the Canadian auto sector to weather the storm of downsizing quite well. **First**, based on ratings released in the Habour Report and by JD Power and Associates, a number of Ontario plants receive top marks for quality and productivity. The fact, for example, that Oshawa #2 plant was given among the highest ratings in both reports was no doubt a factor in General Motor's decision to award the Camaro to the #2 plant, hence keeping it running beyond 2008. **Second,** despite the fact that the sharp rise in the Canadian dollar has led to a deterioration in competitiveness in Canada vis-à-vis the United States, producers still benefit from significantly lower costs of health care and a highly educated workforce. **Third,** Canadian governments are also beginning to address infrastructure deficiencies, including those at the border. **Fourth**, the level of corporate taxation and support for research and development is more favourable in Canada than in the United States. And, **finally**, the Canada's Automotive Partnership, which includes a partnership of the Ontario government, federal government, unions and auto companies, has been successful in powering debate and strategy on improving the sector's standing in the global marketplace.

Light vehicle output to rebound in 2008

Despite these bits of good news that have helped to alleviate some of the concerns that have recently emerged about the health of the auto sector, Canadian light vehicle production is expected to give up some further ground in 2007. Nevertheless, the decline is expected to be considerably smaller than both last year's estimated 4.3% drop and that likely to be posted in the United States (-2.6%). Furthermore, a rebound in North American sales and the start-up of production at Woodstock's Toyota plant should lift Canadian light vehicle output by a moderate 2% in 2008, pushing the nation's share of total North American output up slightly to 17% – at the high end of the range of 15-18% recorded over the past decade. Over the next few years, Ontario's position as the largest automotive jurisdiction in North America is unlikely to be rivaled.



AUTOMOTIVE SALES AND PRODUCTION				
	Per cent change			
	2005	2006E	2007F	2008F
SALES OF LIGHT VEHICLES				
NORTH AMERICA	0.9	-1.7	-1.0	2.0
Canada	3.2	2.1	-0.8	1.0
United States	0.5	-2.3	-1.2	2.0
Mexico	3.3	1.4	1.3	3.1
PRODUCTION OF LIGHT VEHICLES				
NORTH AMERICA	0.0	-2.9	-1.8	1.4
Canada	-1.5	-4.3	-1.2	2.0
United States	-0.4	-6.0	-2.6	1.0
Mexico	7.8	21.5	2.0	2.5

Forecast by TD Economics as at Jan 2007
Source: DesRosiers Automotive Reports, Ward's, TD Economics

Other highlights in the TD Economics' sales and production forecast include:

- The share of the Big Three in North American sales should slip further in 2007, but then stabilize in 2008.
- Nonetheless, consistent with the goal of the Big Three to bring production more in line with sales, the output share of the U.S.-based companies is expected to fall to a new low of 57% in 2008.
- On a continent wide basis, the recent trend of a rising import share is expected to remain intact over the next two years, as North American production of light vehicles underperforms sales. In the United States, imports currently account for about 20% of total light vehicle sales, while in Canada the current share is even higher, at about 25%.

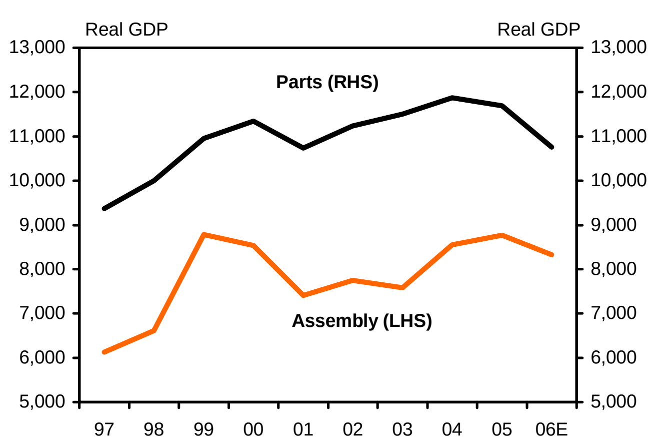
Outlook for the parts sector

If the challenges on the assembly side were not enough, Canada's parts sector has been encountering even more difficult conditions. Canadian total parts output (as measured by real GDP at basic prices) fell an estimated 8% in 2006, compared to a 5% decline in motor vehicle output. Furthermore, parts employment has been pared by about 5,000 jobs over the past year versus a reduction of 3,000 jobs in the assemblies sector. There has been much focus over the past few years on the woes of large U.S. parts makers, notably the filing for bankruptcy protection of both Dana Corp. and Delphi, the latter being the largest supplier to General Motors. And although Canada's largest parts companies have been holding up comparatively well, the recent revenue warning and announced layoffs by Magna International suggest that even Canada's parts powerhouses are starting to feel the chill winds of the slowing North American auto market.

Parts major contributor to Ontario's economy

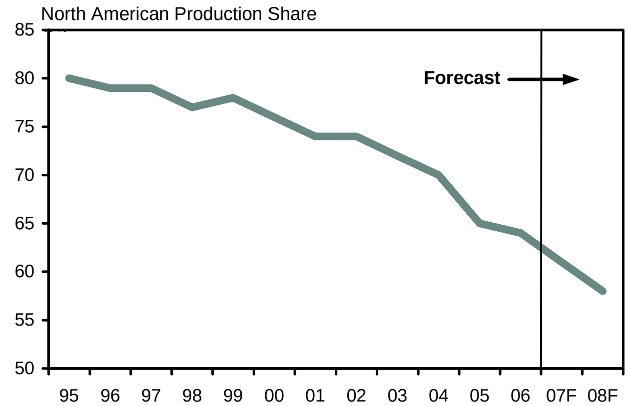
The impact of declining parts activity is not being lost on the Ontario economy – the home of the lion's share of auto and parts production in the country. While the importance of the assembly sector is well recognized, there is less awareness that the parts sector (close to $11 billion in real terms) is a greater contributor to Ontario real GDP than assemblies ($8 billion). As a job generator, the parts industry employs 90,000 individuals compared to 50,000 in assemblies. However, it remains the case that Canada continues to record a substantial net trade surplus in assembled vehicles ($14 billion), but a deficit in its parts sector ($11 billion). Not surprisingly, the impact of lower U.S. auto sales last year was not lost on the national trade balance, as the overall surplus in autos and parts slipped from $10 billion in 2005 to an estimated $3 billion in 2006.

AUTO ASSEMBLIES & PARTS OUTPUT IN CANADA



Source: Statistics Canada/Haver Analytics, TD Economics

BIG 3 SHARES IN NORTH AMERICAN LIGHT VEHICLE PRODUCTION



Forecast by TD Economics as at January 2007; Source: Statistics Canada/Haver Analytics

Dependence on Big 3 sales hurting parts producers

The dramatic decline in output of the Canadian parts industry in recent months has been largely attributable to cutbacks among the Big Three, which have necessitated reduced procurement of parts. This has had significant ripple-through effects for the industry, since the Big Three have tended to source a significant share of their parts from domestic suppliers. Complicating matters is the fact that the U.S. automaker's deteriorating financial situation has placed them under more pressure to secure price cuts from their suppliers and/or download additional responsibilities to parts makers.

Rising competition from China a structural challenge

In addition to the dramatic decline of the Big Three's importance in the U.S. market and strong run-up in the Canadian dollar since 2003, the rising competition from developing markets has emerged as a key structural challenge facing Canadian parts suppliers. This trend will only intensify over the next few years, as the Big Three look to diversify the supply base and reduce production costs through the purchase of lower-cost foreign parts.

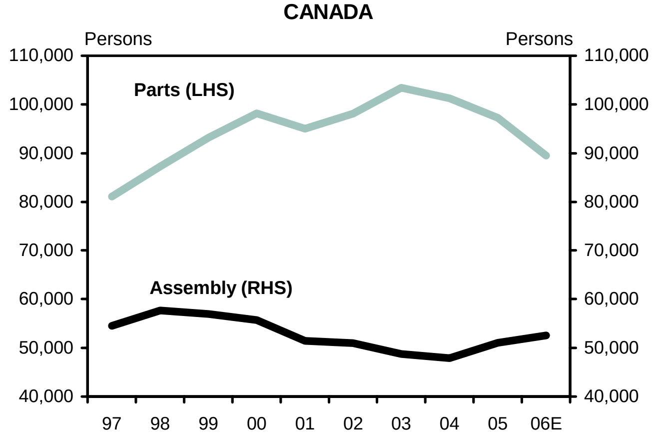
In recent years, there was much written about Mexico's increasing influence in the parts sector in the large U.S. market. In particular, even though Canada continued to be the main exporter of higher-value added and more sophisticated components as well as assembled engines, Mexico has overtaken Canada as the leading supplier to the United States auto market. In 2005, Mexico's share of

U.S. imports jumped to 25%, 3 percentage points higher than Canada's 22% share.

More recently, however, this concern has shifted to China, which is making significant progress in penetrating the North American market. The level of parts imports from China remains relatively small compared to that of Canada and Mexico, but its growth rate is staggering. For example, China's share of U.S. parts imports was almost non-existent at the start of this decade. Today, the country's share stands at about 5%. China's automotive policy, unveiled in 2004, calls on domestic firms to expand overseas, with a goal of US$70-100 billion of exports in auto parts by 2010 – a far cry from the $3 billion tally posted in 2003. And, as noted, this goal is likely to be partly accomplished through increased demand from U.S. manufacturers. General Motors, for example, plans to increase its parts purchases from China twenty-fold in six years, to US$4 billion. GM has also exhorted its own suppliers to consider building plants in China in order to remain competitive.

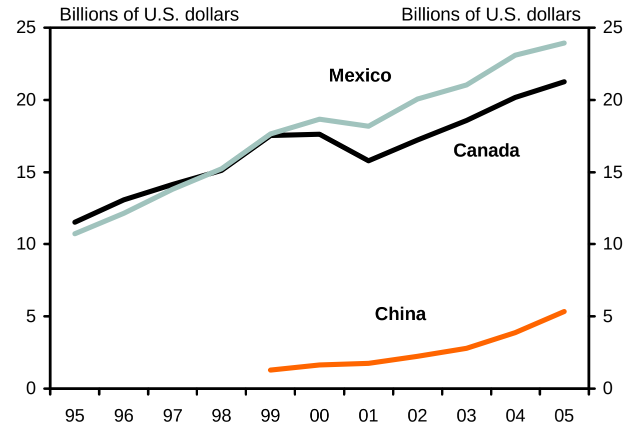
So far, progress made by China in penetrating the North American auto market has been in the area of parts, although many believe that it is only a matter of time before the competitive challenge extends to assembled vehicles. In addition to the chance of a protectionist response by U.S. lawmakers, one impediment facing Chinese producers in exporting automobiles to the North American and European markets is likely to be – at least initially – quality concerns. Still, the lion's share of China's North American parts imports has historically been lower-value-added wheels and tires sold in the "aftermarket" – i.e., to retailers rather than the original equipment manufacturers – where price is the more important consideration. However, the increasing interest in Chinese parts by OEMs shows that these Chinese companies have started to improve quality of their products and move up the value added curve.

AUTO PARTS & ASSEMBLY EMPLOYMENT IN CANADA



Forecast by TD Economics as at January 2007
Source: Statistics Canada/Haver Analytics

SOURCES OF U.S. AUTO PARTS IMPORTS



Source: U.S. Census Bureau

Opportunities being created for parts producers

The downsizing of Big Three operations and the emerging auto market in China is creating challenges for Canadian parts suppliers. But it is also generating opportunities. For one, the scheduled downsizing of the parts facilities by the U.S. automakers will mean less production in-house. To the extent that those parts are still required in the production process, parts producers could benefit from increased outsourcing. In addition, Canadian companies may be well-positioned to benefit from the misfortunes of other companies. Magna, for example, recently won a share of the frame and some structural components in the production of Ford Motor Co. F-150 pickups from struggling Dana Corporation. Undoubtedly, other big Canadian names – including Linamar, Martinrea and the Woodbridge Group – are also scouring the market in search of business opportunities.

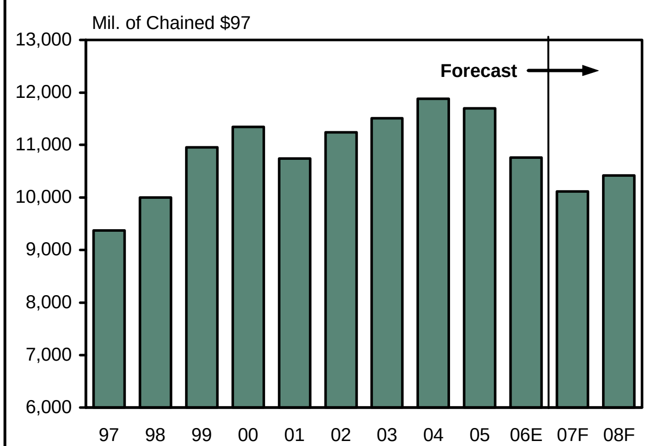
Over the longer term, China's rapidly-growing market also offers significant opportunities to Canadian parts suppliers, in light of the fact that the country remains a net importer of auto parts and components. Successful penetration of the Chinese market would not only build business, but also help to lessen the reliance of Canadian producers on the U.S. market.

The bottom line on parts – no quick recovery

Over the next few years, the negative impacts of Big Three downsizing and ongoing competition from Chinese imports are likely to translate into a 6% drop in real output in 2007 and hold back the rebound in 2008 to only about 3%. As a result, production is expected to remain some 10% below its peak level reached in 2004 next year. On a more positive note, a number of Canadian parts producers appear to be well-positioned to grow their businesses over the next few years amid the exiting of the Big Three from some lines of businesses and further restructuring within the sector. Success in taking advantage of opportunities both at home and abroad will be vital to ensuring the sector's sustainability over the longer run. Happily, the $7 billion in announced investment plans in Ontario's over the past few years is a vote of confidence in the Canadian auto and parts sector's ability to live up to that challenge.

From a longer-term perspective, one of the biggest challenges facing Canadian parts producers will come on the wage side. And, here, we're just not referring to the direct impact of competition from low-cost China. We're also talking about developments in the United States, which in turn partially related to competition from emerging markets as well as in the southern U.S. states. In particular, in addition to scaling back workers' benefits, the management of the U.S. operations of Delphi is trying to secure a union agreement that would reduce wages to about US$16-17 per hour before it emerges from bankruptcy protection. That concession would mark a sharp cut from the US$27-28 paid under the most recent agreement and a peak of more than US$45 when the company was a unit of General Motors. Such a deal would place even more pressure on Canadian parts companies to adopt a more competitive wage scheme and to ramp up productivity.

AUTO PARTS OUTPUT IN CANADA



*Historical data ends in Oct. 2006; Forecast by TD Economics as at Jan. 2007; Source: Statistics Canada/Haver Analytics

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