TD Bank Financial Group

TD Economics

Observation

August 6, 2009

U.S. CASH FOR CLUNKERS TO PROVIDE LITTLE CASH FOR CANADA

HIGHLIGHTS

- **The Senate is likely to approve $2 billion additional funding for CARS**
- **CARS will provide a temporary boost to U.S. sales in the current quarter, but at the expense of sales in the fourth quarter and in early 2010**
- **Only two of the top ten vehicles purchased under the program are manufactured in Canada**

Before leaving for their August recess at the end of this week, it is widely expected that the U.S. Senate will approve a US$2 billion extension of the Car Allowance Rebate System (CARS). The program, more commonly referred to as 'Cash for Clunkers', kicked off with a bang, as consumers were eager to take advantage of the hefty incentives on new automobiles. The impact of the program has led us to revise our auto sales and production forecast (see table on page 2). While a sharp bounce in sales in the U.S. would typically be beneficial for Canadian assembly plants, the impact of this particular program will be limited, as the majority of the vehicles that are being purchased under the program are not Canadian-made.

The Car Allowance Rebate System

The aim of CARS is twofold: to jump-start new car sales and to take gas guzzlers off the road. The program allows for rebates of US$3,500-$4,500 on new higher-mileage vehicles in exchange for the scrappage of less energy efficient vehicles. And some dealers are sweetening the deal even more, by doubling the incentives put in place by the CARS program.

With hundreds of thousands of consumers rushing to cash in on the program, the US$1 billion fund is likely to be tapped out after only two weeks (the program officially began on July 24th, but accepts transactions as of July 1st). The government estimated that the fund would generate about 250,000 trade-ins. But already, as of August 4th, the Transportation Department had received an estimated 157,000 applications, accounting for over 65% of the available funding. Of the vehicles traded in so far, over 80% have been trucks and SUV's, while 60% of the new vehicles sold have been passenger cars. And while the program requires a minimum improvement in fuel efficiency of 4 miles per gallon, apparently the new vehicles purchased have an increased efficiency of about 10 miles per gallon on average compared to the vehicles being scrapped.

The widespread popularity of the program, which was initially scheduled to run until November 1st (or until the US$1 billion was exhausted), has prompted the House of Representatives to quickly approve a US$2 billion addition to the fund in order to keep the program running. The measure is now in the hands of the Senate, where some members have indicated that fuel efficiency standards should be a little stricter in order to have a bigger impact on the environment. Nonetheless, the Senate is expected to vote in favour of the extension of the program by Friday.

Another US$2 billion in funding could boost sales by another 500,000 units, on top of the 250,000 expected to be generated from the first chunk. Accordingly, U.S. sales could potentially reach 10 million units this year, compared to the seasonally adjusted annualized rate (SAAR) of 9.5 million units seen during the first six months of the year.

But while automakers are thrilled with the increased

AUTOMOTIVE SALES AND PRODUCTION								
	Per cent Change				Number of Units (000's)			
	2007	2008	2009F	2010F	2007	2008	2009F	2010F
	SALES OF LIGHT VEHICLES							
NORTH AMERICA	-2.1	-15.8	-23.2	10.0	18,835	15,856	12,175	13,390
Canada	2.6	-1.1	-16.0	8.4	1,653	1,636	1,375	1,490
United States	-2.5	-18.0	-24.2	10.0	16,089	13,195	10,000	11,000
Mexico	-3.5	-6.2	-22.0	12.5	1,093	1,026	800	900
	PRODUCTION OF LIGHT VEHICLES							
NORTH AMERICA	-1.5	-16.1	-33.6	10.8	15,021	12,607	8,370	9,275
Canada	1.8	-19.6	-31.5	10.4	2,542	2,043	1,400	1,545
United States	-3.0	-19.3	-35.6	11.0	10,473	8,456	5,450	6,050
Mexico	2.6	5.1	-27.9	10.5	2,006	2,108	1,520	1,680

Forecast by TD Economics as at August 2009

Source: DesRosiers Automotive Reports, Ward's, TD Economics

traffic in their showrooms, we caution that this sharp uptick in sales will prove to be temporary. Economic conditions have shown some improvement in recent months, but many of the underlying factors that drove auto sales down over the past year are still present. In particular, the labour market remains extremely weak, as employers continue to shed jobs – a trend that is likely to continue into the first half of 2010. Credit conditions have improved, with the cost of credit coming down, but access to credit is still more difficult to obtain as lenders are exercising more caution. So without a job, big ticket items will be hard to afford – even with hefty incentives.

Furthermore, several consumers who participate in the program will be those contemplating scrapping their old car for a new one in the next couple of years anyway. Hence, for these individuals, the rebate is simply speeding up the process. All told, while the CARS program is bringing forward new car sales, boosting the third quarter performance, it will likely come at the expense of sales down the road, in the final quarter of this year and into 2010. Accordingly, we have adjusted our U.S. sales and production forecast to reflect the temporary pop in sales this year.

Implications for Canadian Production

Given that about 80% of all vehicles produced in Canada are exported to the U.S., the sales market Stateside typically has serious implications for Canadian auto manufacturing. However, Canada produces more gas guzzlers than fuel sippers. And with the CARS program requiring increased fuel efficiency, the impact on production north of the border will be minimal. In 2008, Canada supplied the U.S. market with about 1.6 million vehicles, accounting for about 12% of total U.S. sales. Applying that same share to the estimated 750,000 unit sales boost from the CARS program would translate to an increase in Canadian production of about 90,000 vehicles. However, with only two of the top 10 vehicles purchased under the program built in Canada – the Toyota Corolla and the Honda Civic – the actual benefit to Canadian output is likely to be much smaller. Output of these two vehicles is likely to rise in the near term; however, total production in Canada will remain quite weak for some time.

Dina Cover, Economist
416-982-2555