COVID-19 To Drastically Slow Near-Term Canadian Auto Sales & Production

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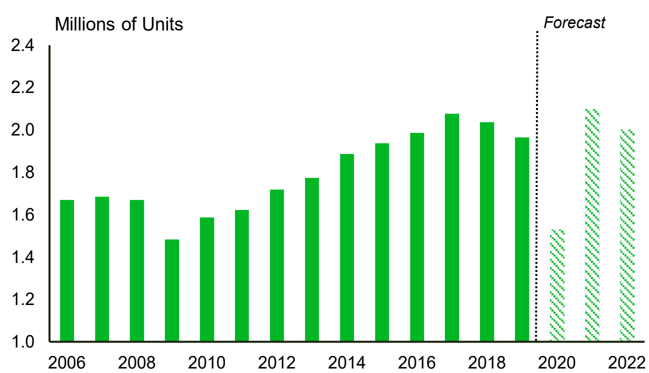
Highlights

- COVID-19 has already started to show its vicious bite on both Canadian and U.S. economic activity. Auto sales and production have also succumbed to a sudden stop in activity, with both expected to continue to fall sharply over the coming months.
- In fact, March sales volumes in Canada slumped by 47% month-on-month – the greatest monthly decline ever recorded. With non-essential businesses shutdown across the country, April promises to be far worse, with monthly sales potentially falling as low as 40,000 (480,000 SAAR) units.
- Production across North American automakers was halted as of the third week of March. While return dates are currently slated for some time in early May, no formal dates have been announced. Assuming production returns to near full capacity by May, North American production will be lower by 2.5 million units, expected to total 14.2 million for the year – down 13% compared to the year-prior.
- From a production standpoint, Canada stands to be hardest hit. The temporary stoppage in North American assemblies comes atop the closure of GM's Oshawa plant, which shut its doors last year. Canadian production is now estimated to fall by 20% or 400,000 units compared to 2019.

The global economy is set to stall in 2020 as countries around the world grapple with the COVID-19 outbreak. Both the Canadian and U.S. economies have already started to show a pronounced slowdown in economic activity as of March. It is expected that conditions will continue to deteriorate over the coming months, as attempts to "flatten the curve" lead to unprecedented declines in both real GDP and employment. Unsurprisingly, our outlook for both Canadian and U.S. vehicle sales have been revised sharply lower. Sales for Canada are now expected to average 1.5 million for 2020, down nearly 23% relative to the year-prior. (Chart 1).

Weakness in Canadian sales numbers was already evident in March, where volumes slumped by 47% month-on-month (m/m) – the single greatest monthly decline ever recorded. What's perhaps more surprising than the magnitude of the decline, is how fast it occurred. Through the first few weeks of March, volumes were tracking a relatively "normal" pace of sales for the month. However, with all provinces enforcing various social distancing measures by mid-month, sales completely collapsed through the second half of March. This stall in sales will almost certainly continue through all of April and likely into next month, as continued efforts to contain the spread of COVID-19 have led to the closure of all non-essential businesses across the entire country, including front-end dealerships. While most dealerships have shifted to having a stronger online presence, it seems unlikely

Chart 1: Canadian Vehicle Sales Expected to Fall Sharply This Year



Source: DesRosiers Automotive, Stats Canada, TD Economics that online purchases will provide a meaningful offset over the coming months. Gven both the magnitude of the shock and current level of uncertainty, consumers are likely to forgo near-term purchases and wait until better economic conditions prevail.

Under TD Economics [revised baseline forecast](), we expect the extreme disruptions in economic activity to persist into mid-May, before we start to see a gradual return to economic activity. Gradual is the key word. Despite the duration of the shock expected to be just several months, it is assumed that it will take two-years to recover all the lost economy-wide output. Similar disruptions are assumed for vehicle sales as well, where monthly volumes for April could be as low as 40,000 units (480, 000 SAAR) – 80% below year-ago levels (Chart 2). And while we expect some demand to come back in the latter half of May, it's highly unlikely that we'll see a complete return to normal activity (plus any lost purchases) in just one month. Sentiment has been damaged and it will likely take at least several months before we see a return to a "normal" (1.9M – 2.0M) level of sales.

On the supply side, production across all North American plants has been halted as of the third week of March. While there's still no set date for workers to return, most automakers have already said that production will not resume until at least early May, with official start dates continuing to be "reassessed" on a week-to-week basis. Even if full production returns by May, that will result in six weeks of lost output across North America, equating to a loss of 2.5 million units. Canada stands to be hardest hit, as the current production stoppage comes atop the closure of GM's Oshawa plant, which ceased production at the end of last year. Overall, North American production is now expected to slip to 14.2 million units, or roughly 13% below year-ago levels. (Table 1)

Table 1: Canada/U.S. Sales & Production

	Number of Units (millions)			Per Cent Change		
	2019	2020F	2021F	2019	2020F	2021F
Sales of Light Vehicles						
U.S.	16.9	14.0	17.6	-1.7	-17.5	26.2
Canada	2.0	1.5	2.1	-3.6	-22.6	38.0
Production of Light Vehicles						
North America	16.3	14.2	16.6	-4.2	-13.0	16.9
U.S.	10.7	9.6	11.2	-4.1	-10.5	17.1
Canada	1.9	1.5	1.7	-6.2	-19.8	13.6
Mexico	3.7	3.2	3.7	-4.8	-14.9	16.8

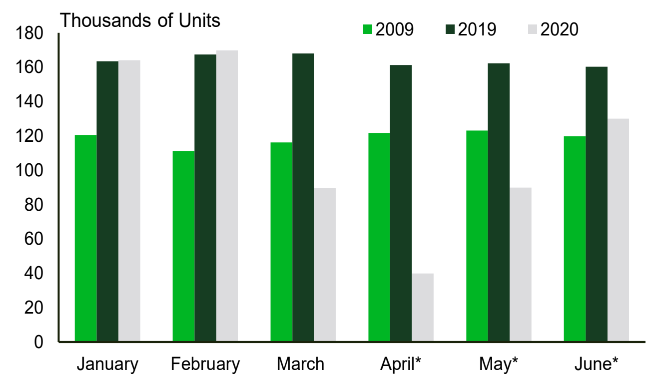
Source: Wards Auto, TD Economics

Do other countries offer guidance?

With Canada still recording increased spread of COVID-19, we looked to other impacted countries, which are further along the curve – mainly China, Italy and Spain – as a primary source for grounding our sales assumptions with respect to both depth and duration.

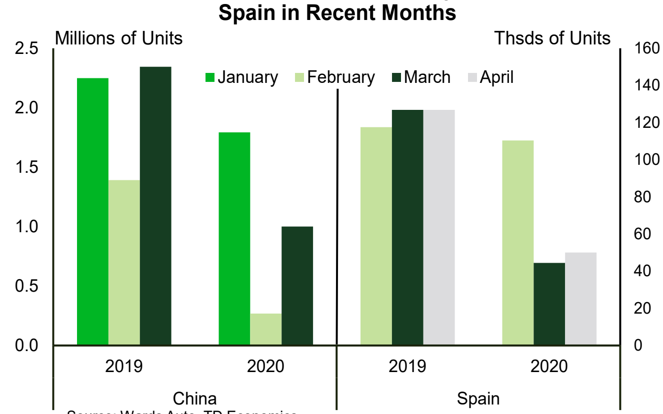
Vehicle sales in Spain were lower by 69% last month and are now down by over 30% year-to-date (Chart 3). At

Chart 2: Monthly Auto Sales to Fall to Unprecedented Lows over Coming Months



Source: DesRosiers Automotive, Stats Canada, TD Economics.
Notes: April, May, June values for 2020 denote TD Economics forecast.

Chart 3: Sales Have Fallen Sharply in China & Spain in Recent Months



Source: Wards Auto, TD Economics
Note: March data is a projection for China. April data is a projection for Spain.

this point, April isn't shaping up to be much better, as the country is set to remain in lockdown until at least April 25th. Assuming sales remain somewhat on par with March volumes (~50,000 units on the month), that would imply sales between February and April (COVID-19 impacted months) were lower by 49% when compared to year-ago levels. A similar story is likely to unfold in Italy, though current data only extends as far as February. Sales were lower by 8% year-over-year, which was comparatively worse than Spain – down 6% y/y. Moreover, with the first lockdown measures coming into effect in late-February, initially including just the northern regions but later extended to include the entire country, sales for both March and April will likely be on par with, if not worse than Spain.

In the case of China, sales data also only extends as far as February. However, because China is further along in its recovery from the virus, there is still some information we can glean through the first two months of the year. Year-to-date sales are currently down 43%, with February being a particularly bad month – falling by over 80% relative to the year prior. With some travel restrictions being lifted and most people gradually returning to work by late last month, we should see some bounce back in March compared to February's lows, but sales will likely remain well below year-ago levels. Assuming this to be true, year-to-date sales could be as much as 50% lower after accounting for the March data.

What can we take from both Spain and China's experiences? In both cases, lockdown measures from start to finish are currently looking like they will last approximately two months, with impacts on sales persisting for about three months. Moreover, during that time, sales in both cases are lower by approximately 50%. We use very similar assumptions to ground both our Canadian and U.S. sales forecast. Specifically, that social distancing measures remain in place for two months, extending until mid-May, which results in March, April and May sales being severely impacted. Over this three-month period, it is assumed that sales are lower by roughly 50%.

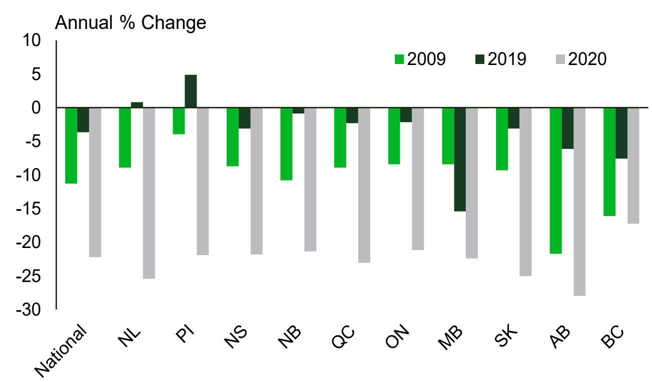
It should be cautioned, however, that both Spain and Italy are only a few weeks ahead of Canada and the U.S. in terms of curve flattening. There is still considerable uncertainty with respect to both countries' exit strategy and how it will compare to those in Canada and the U.S., which could imply even deeper declines and a more prolonged recovery. Not only that, but containment efforts could also vary greatly across the U.S. and Canada, making one more vulnerable than the other. This is particularly true when we consider the fact that the U.S. currently far exceeds Canada in terms of confirmed COVID-19 cases when measured on a per-capita basis – suggesting the U.S. could have a relatively more protracted recovery. We must also keep in mind that the curve flattening measures undertaken by China were far stricter than what is currently being imposed in either Europe or North America. So, while we assume the timing of lockdown measures to roughly follow what was imposed in China, the reality is they could extend far longer.

Either way, it's fair to say that these near-term forecasts come with considerable uncertainty. Economic correlations that typically hold in "normal" times are currently broken, making our forecast largely assumption based. Relying on other countries past experiences to glean some insight is logical, but by no means is exhaustive. Every country has been impacted differently by COIVD-19 and response efforts have become increasingly tailored as more information is gained.

Will vehicle sales in some provinces be worse off?

Over the near-term, the short answer is no. Sales across all provinces will be hit, as moves to limit the spread of the virus lead to major disruptions in economic activity across the entire country (Chart 4). Once current social distancing measures start to be relaxed, we are likely to see some divergence across provinces. As it currently

Chart 4: 2020 to Bring Sharp Declines in Vehicle Sales Across All Provinces



Source: Stats Canada, TD Economics

stands, Quebec has been the province most impacted by COVID-19, with the number of confirmed cases nearly double that of Ontario. This could lead to a slower "return to normal" relative to other provinces, which would result in a more protracted recovery in economic activity, and hence sales. Alberta, Saskatchewan and Newfoundland will also be slower to recover given the recent collapse in oil prices. In fact, we have already seen many oil producers having slashed capital spending plans, and in some cases, stopped production altogether. The effects of this will be felt at the household level through this year and next. Employment growth across all three provinces will likely be slower than the national figure, ultimately weighing on household incomes. During this time, vehicle sales are also expected to underperform, just as they did during the last oil shock several years ago. Ontario and British Columbia stand to outperform the national through the second of half of this year and into 2021, provided containment efforts (particularly in Ontario) prove successful. Both provinces have gone further than most in terms of providing fiscal stimulus to both households and businesses, helping to dampen the near-term shock and support the recovery. Moreover, both Ontario and British Columbia are best positioned to see a strong bounce back in housing activity through the second half of this year, following several months of lost home sales. Stronger home sales across both markets should put upward pressure on prices, and lead to stronger wealth effects, which should provide an extra bump to vehicle sales (Table 2).

Bank of Canada and Federal Government step-up with unprecedented policy measures

Both the Bank of Canada and federal government have taken huge steps over the last month to provide an unprecedented amount of monetary accommodation and fiscal stimulus in an attempt to minimize the economic damage. Over the course of several announcements, the Bank of Canada has now cut its benchmark interest rate by 150 basis points – bringing the overnight rate back to the lower bound – as well as launched an open-ended asset purchase program. Assets eligible for purchase include government securities (across all maturities) at a rate of $5B per week, as well as up to $500M per week of Canada Mortgage Bonds, $50B in provincial bonds and $10B in corporate bonds.

From a fiscal standpoint, the Canadian government has taken a two-prong approach to providing relief to both households and businesses. The first prong is the Canadian Emergency Relief Benefit (CERB), which provides temporary income support to those individuals whose employment situation has been directly impacted by COVID-19. The CERB provides $500 per week for up to 16 weeks, to those who have lost incomes between March 15th and October 3rd. The second prong is a wage subsidy program that aims to pay 75% of employees' salaries, up to a maximum of $847 per week, for firms who have experienced at least a 15% drop in revenue. The program is wide in scope, covering nearly all types of workers including, part-time, seasonal, and temporary. As it currently stands, the Wage Subsidy Program will run for three months, covering mid-March to early June.

The announced fiscal stimulus measures to date will go a long way in bridging the gap for those who have been directly impacted by COVID-19. The CERB looks to be particularly impactful for lower-income workers. Under the EI system, the maximum monthly payout is approximately $2,500 (55% of the maximum insurable earnings of$ 54,800 per year), but someone who earns $40,000 per year would receive just 1,800 per month in EI, considerably less than what the CERB provides. On the flip side, the Wage Subsidy Program incentivizes employers to keep employees on payroll through the near-term, helping to speed the economic recovery, should current containment efforts begin to be relaxed over the coming months.

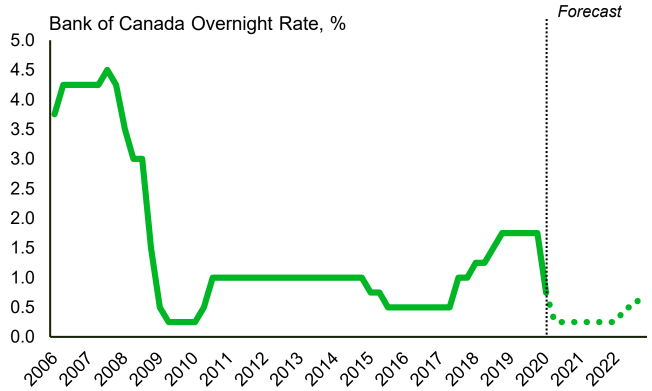
From an interest rate standpoint, we believe the Bank of Canada will stay at the lower bound through to the

Table 2: Vehicle Sales by Province

	Annual Percent Change										
	National	NL	PI	NS	NB	QC	ON	MB	SK	AB	BC
2019	-3.7	0.8	4.9	-3.1	-0.9	-2.3	-2.2	-15.4	-3.1	-6.1	-7.6
2020	-22.2	-25.5	-21.9	-21.8	-21.4	-23.1	-21.2	-22.4	-25.1	-28.0	-17.3
2021	37.2	33.5	38.9	37.7	39.2	38.4	37.5	36.7	34.9	30.8	40.0

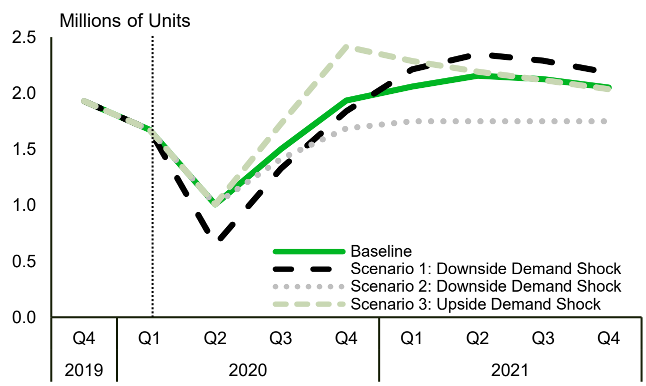
Source: Statistics Canada, TD Economics

Chart 5: Bank of Canada Likely to Remain at The Lower Bound Through 2021



Source: Bank of Canada, TD Economics

Chart 6: Risks to Sales Outlook are Increasingly Skewed to the Downside



Source: DesRosiers Automotive, Stats Canada, TD Economics

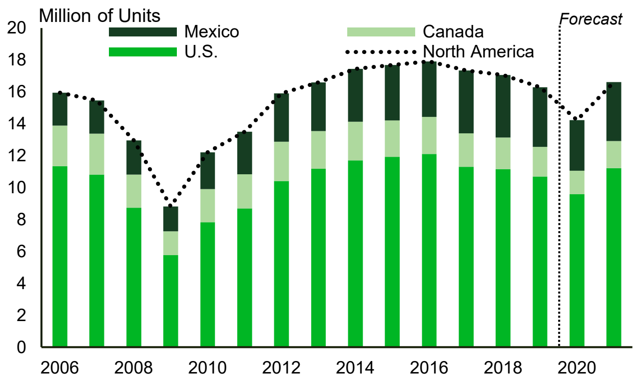
first half of 2022, before gradually lifting rates off the floor (Chart 5). Moreover, it's current open-ended asset purchase program will continue at least through to year-end, keeping considerable downward pressure on long-term yields. At the time of writing, the 10-year yield on a Canadian government bond is roughly 100 basis points (bps) lower year-to-date, and currently yielding around 0.6%. While some of this downward movement has manifested in lower consumer rates, widening spreads have pressured cost of funds and has so far limited the pass-through to auto financing rates.

Risks to the forecast?

We've already highlighted the main risk – containment efforts proving unsuccessful and hence a longer duration stress. Such a scenario would not only result in a deeper decline in Q2 sales, but also lead to a slower recovery through the remainder of the year (Chart 6 --- Scenario 1: Downside Demand Shock). The "lost" purchases in 2020 are somewhat made up for in 2021, hence why Scenario 1 overshoots the baseline forecast. There's also a chance that consumer confidence is slower to return, even if containment efforts prove successful. This could be the result of deeper scarring effects in Canada relative to the U.S., given the increased vulnerabilities with respect to the elevated level of Canadian household indebtedness. The uncertainty could manifest in a few different forms, either by the consumer delaying the purchase or perhaps substituting to the used market (Chart 6 --- Scenario 2: Downside Demand Shock). In both cases, the sales recovery remains below the baseline through 2020/21. While it may currently seem unfathomable, we can't rule out that demand is perhaps faster to recover through the second half of the year once social distancing measures start to become relaxed (Chart 6 --- Scenario 3: Upside Demand Shock). Key to this scenario is the assumption that demand is coming through from those individuals whose incomes hadn't changed through the health crisis, but did temporarily reduce spending habits, thereby creating a great deal of discretionary spending potential. With potentially even lower borrowing costs given recent Bank of Canada actions, and dealers likely to be offering heavy incentives through the second half of the year, we could see a sharper release of pent-up demand, and hence stronger sales in 2020:H2.

Outside of the scenarios, we could also see a change in composition of the type of vehicle purchased. The shift to larger, more expensive light trucks has been a steady upward trend over the last decade, with luxury brands also becoming increasingly popular. However, the recent sharp decline in global equity markets may help slow luxury purchases and perhaps even drive substitution towards smaller, low cost vehicles. This is all the more true should we see a pronounced slowdown in housing activity, which leads to some pullback in home prices. Wealth effects have historically shared a strong correlation with Canadian vehicle sales, and any meaningful correction in home prices would likely have an impact on the composition of sales purchased.

Chart 7: Six Weeks of Plant Closures to Shave 2.5 Million from 2020 Production



Source: Wards Auto, TD Economics

Production to also feel effects of COVID-19

The supply side is also being impacted by COVID-19. While it was initially thought that this would be due to supply chain disruptions from Asia/Europe, the spread of COVID-19 to North America has more recently forced domestic automakers to temporarily shut down production facilities. Most plant closures occurred through the third week of March, and it is now assumed that production won't resume until early-May. This will eliminate six weeks of supply from the original 2020 production plan, and it is assumed that because facilities are already running near capacity, the lost production is unlikely to be made up for later in the year. Under this assumption, North American output would be lower by 13% or 2.5 million units, compared to the pre-COVID-19 forecast (Chart 7). The temporary shutdowns come atop of what was already set to be another challenging year for Canadian auto production, as the closure of GM's Oshawa plant was already set to weigh on production. Auto production in Canada for this year is now expected to slip to 1.5 million units, down 20% compared to year-ago levels.

Bottom Line

Economic disruptions as a result of COVID-19 are already being felt across Canada and have forced us to substantially cut our outlook for 2020. Our vehicle sales forecast has also been revised sharply lower, with sales now expected to average 1.5 million units this year, well below the 2.0 million previously forecasted prior to COVID-19.

Production across all North American automakers has also been temporarily halted, with current information suggesting that plants will remain closed through the end of April. This would imply a six-week shutdown on assemblies, which will drag this year's production down to 14.2 million units, down 13% compared to the year-prior. The temporary shutdowns come atop of what was already set to be another challenging year for Canadian automakers, as the closure of GM's Oshawa plant was already set to weigh on production. Auto production in Canada for this year is now expected to slip to 1.5 million units, down 20% compared to year-ago levels.

We are still early days and forecasting potential impacts in this rapidly changing environment is by no means an exact science. Economic relationships that are typically observed in normal times are currently broken, and hence we need to rely more on our priors and other countries experiences to help inform the forecast. This embeds more uncertainty, particularly in our near-term estimates. Should social distancing guidelines extend beyond what we have assumed, the economic disruptions will be both more prolonged and deeper than what is currently forecasted. Buckle up, we are in for a crazy ride over the coming months!

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