

Canada's Car Economy

Michael Gregory, CFA, Senior Economist

U.S. President Eisenhower selected General Motors' head Charles Wilson to be his Secretary of Defense in 1953. During his Senate confirmation hearings, Wilson was asked whether his pedigree would affect his ability to make decisions adverse to the interests of GM. He responded: "*what was good for the country was good for General Motors and vice versa*". This statement became a mantra for the importance of GM and the rest of the automotive industry to the U.S. economy, but it could be chanted even louder north of the border.

Canadian automotive production represented 2.2% of real GDP in 2006, greater than the sector's 1.3% share in the U.S. (these are the latest comparable data, *Chart 1*). But, the Canadian share slipped to 1.8% for the 12 months ending August 2008, reflecting

braking automotive shipments on both sides of the border and the negative legacy of a strong loonie on all local factory activity (*Chart 2*). We estimate that the U.S. share slipped to 1.1% for the four quarters ending 2008 Q3.

However, GDP by industry is a value-added concept, measuring the value of a sector's outputs less the value of its inputs. Although constructing GDP this way avoids multiple counting of the same production, it underestimates the full economic exposure to an industry. To assess the latter we ask: What is the economic impact if domestic automotive production ceased? Not only would the automotive sector's value added be lost, but the valued added of all the sectors that provided inputs to automotive production would be lost (such as from the materials industries). Calculating these potential amounts is problematic.

The gross output of the U.S. automotive sector (its value added plus the value of its inputs) was more than five times larger than its value added alone in 2006. Unfortunately, gross output overestimates the economic impact of domestic automotive production because some inputs are imported. As a point of reference, imported parts represented around 16% of U.S. automotive shipments in 2006 (and have since risen to around 24%), but the actual import share of inputs is probably higher owing to the fact that U.S.-produced parts are themselves made up of imported materials. In Canada, imported parts have been relatively steady at around 40% of total automotive shipments since 2006. If we assume a comparable gross-output-to-value-added ratio for Canadian automotive production, then the economic impact of Canada's automotive

CHART 1
MOTO-VATING THE ECONOMY
(% of real GDP)

Automotive Manufacturing (Vehicles and Parts)

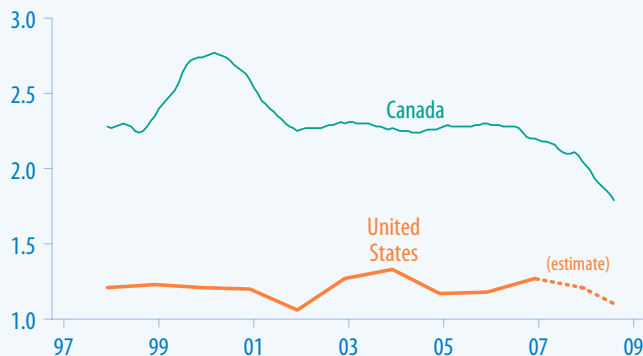


CHART 2
CANADIAN FACTORY JOBS: LOONIE TUNES
Canada

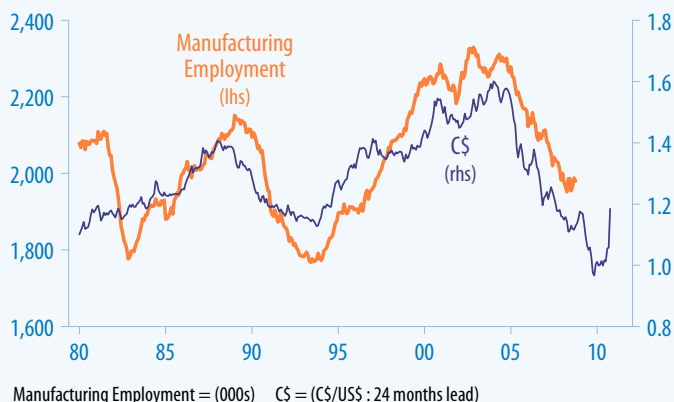


CHART 3
AUTO JOBS DRIVEN DOWN
(% share of payroll employment : 12-mnth m.a.)

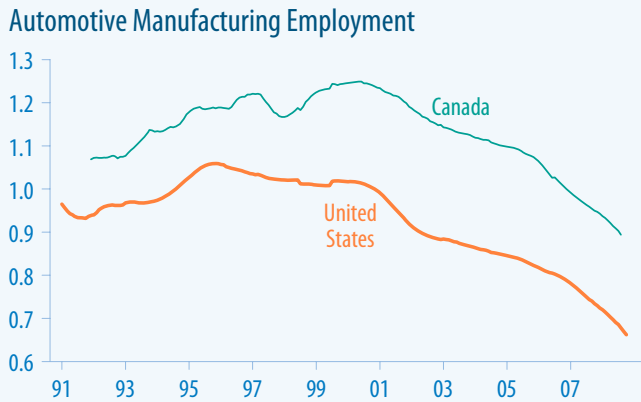


CHART 4
PARTS BEAR JOB LOSS PAIN
Automotive Manufacturing Employment – Canada (000s: 12-mnth m.a.)

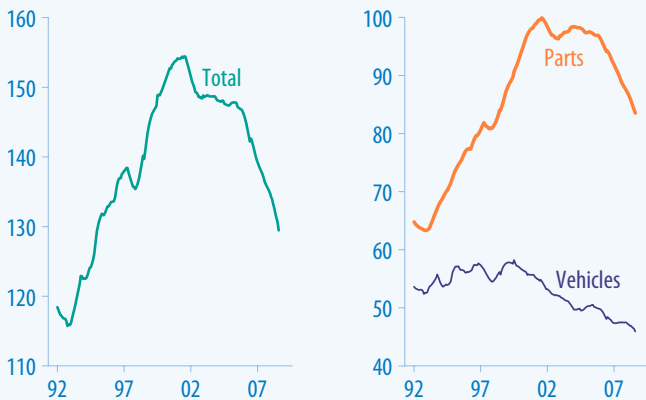
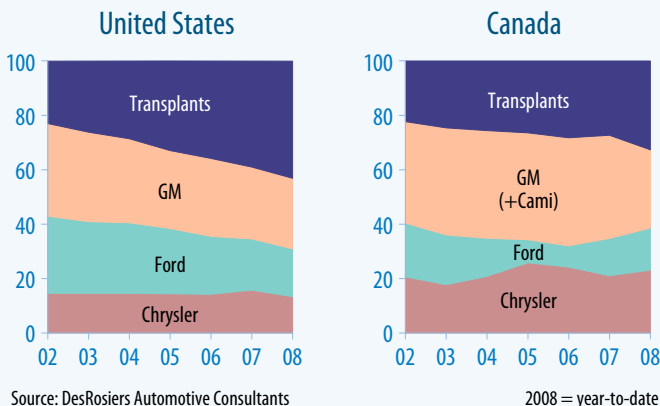


CHART 5
TRANSPLANTS TAKING ROOT
(% share of light vehicle production)



Source: DesRosiers Automotive Consultants

2008 = year-to-date

sector could be two to three times higher than the sector's individual GDP share (and still significantly above the U.S.). And, even this likely underestimates the Canadian economy's ultimate exposure to the automotive sector because we have considered only the production of vehicles and parts as they leave the factory gate. This does not include the marketing and sales functions. For example, the transportation, wholesale, retail and financial sectors all contribute value added.

Employment is another way to assess the economic impact of automotive production. In the 12 months ending August 2008, automotive manufacturing jobs in Canada averaged 129,480. This represents 0.9% of total Canadian payroll employment, and is greater than the sector's 0.6% share of U.S. payrolls (Chart 3). Canadian automotive employment peaked in mid-2001 at more than 154,000 workers—not coincidentally, just a few months before the loonie hit all-time lows under US\$0.62. Since then, nearly 25,000 jobs have been lost, with two-thirds of these on the parts side of the industry (Chart 4). The loonie's multi-year soar to above parity clearly contributed to the job losses and the plant closures. The Canadian figures are not seasonally adjusted, which is why we focus on the 12-month trends. However, if the individual August 2008 (and 14-year low) reading of 122,603 holds, job losses appear poised to hit nearly 32,000, so far. And, in the wake of the lowest U.S. vehicle sales in a quarter century, the industry's employment prospects are dimming despite a more favourable loonie.

There are two other features of Canada's car economy worth mentioning. First, through the first nine months of this year, GM, Chrysler and Ford made up 67% of light vehicle production north of the border, compared to 57% south of the border (Chart 5). The vehicle production shares of GM and Chrysler are higher in Canada than in the U.S., with Ford's share lower. The Big 3 are poised to lose some ground relative to the transplants as the new Toyota assembly plant starts up production next month and GM's Oshawa truck plant is slated to close next year. Second, the industry is disproportionately centred in Ontario.

Bottom line: Canada's relative economic exposure to the automotive sector is greater than America's. This, to paraphrase Mr. Wilson's famous words, means "what's good for GM (and the rest of the industry) is good for Canada too."

The information, opinions, estimates, projections and other materials contained herein are provided as of the date hereof and are subject to change without notice. Some of the information, opinions, estimates, projections and other materials contained herein have been obtained from numerous sources and Bank of Montreal ("BMO") and its affiliates make every effort to ensure that the contents thereof have been compiled or derived from sources believed to be reliable and to contain information and opinions which are accurate and complete. However, neither BMO nor its affiliates have independently verified or make any representation or warranty, express or implied, in respect thereof, take no responsibility for any errors and omissions which may be contained herein or accept any liability whatsoever for any loss arising from any use of or reliance on the information, opinions, estimates, projections and other materials contained herein whether relied upon by the recipient or user or any other third party (including, without limitation, any customer of the recipient or user). Information may be available to BMO and/or its affiliates that is not reflected herein. The information, opinions, estimates, projections and other materials contained herein are not to be construed as an offer to sell, a solicitation for or an offer to buy, any products or services referenced herein (including, without limitation, any commodities, securities or other financial instruments), nor shall such information, opinions, estimates, projections and other materials be considered as investment advice or as a recommendation to enter into any transaction. Additional information is available by contacting BMO or its relevant affiliate directly. BMO and/or its affiliates may make a market or deal as principal in the products (including, without limitation, any commodities, securities or other financial instruments) referenced herein. BMO, its affiliates, and/or their respective shareholders, directors, officers and/or employees may from time to time have long or short positions in any such products (including, without limitation, commodities, securities or other financial instruments). BMO Nesbitt Burns Inc. and/or BMO Capital Markets Corp., subsidiaries of BMO, may act as financial advisor and/or underwriter for certain of the corporations mentioned herein and may receive remuneration for same. "BMO Capital Markets" is a trade name used by the Bank of Montreal Investment Banking Group, which includes the wholesale/institutional arms of Bank of Montreal, BMO Nesbitt Burns Inc., BMO Nesbitt Burns Ltée/Ltd., BMO Capital Markets Corp. and Harris N.A., and BMO Capital Markets Limited.

TO U.S. RESIDENTS: BMO Capital Markets Corp. and/or BMO Nesbitt Burns Securities Ltd., affiliates of BMO NB, furnish this report to U.S. residents and accept responsibility for the contents herein, except to the extent that it refers to securities of Bank of Montreal. Any U.S. person wishing to effect transactions in any security discussed herein should do so through BMO Capital Markets Corp. and/or BMO Nesbitt Burns Securities Ltd.

TO U.K. RESIDENTS: The contents hereof are not directed at investors located in the U.K., other than persons described in Part VI of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001.

™ - "BMO (M-bar roundel symbol) Capital Markets" is a trade-mark of Bank of Montreal, used under licence. © Copyright Bank of Montreal.