



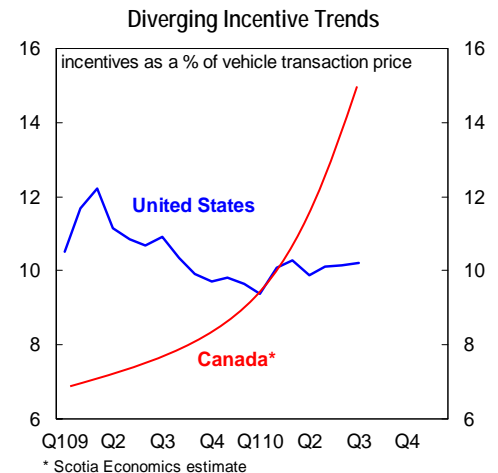
Global Auto Report

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Canadian Auto Market Moves Upscale

— *Enhanced Incentives Prompt Shift to Larger, More Expensive Models*

Global car sales fell below a year earlier in July, a significant slowdown from a 16% surge in the first half of 2010. A double-digit slump in Western Europe, due to the expiry of scrappage incentives, accounted for the fall-off. However, outside of Europe, purchases have also started to moderate, with volumes advancing year-over-year by only 9% last month — the smallest gain since last summer. Purchases held up better in the United States, climbing to an annual rate of 11.5 million units in July, up from a first-half 2010 average of 11.2 million. Higher retail activity accounted for the improvement, climbing to an annualized 9.2 million units in July — the highest level since last year's "cash for clunkers" program and up from 9.0 million in the second quarter and 8.6 million in the opening months of 2010. Strengthening retail sales is a key development for the auto industry, especially since it occurred without much of an increase in incentive spending and against a backdrop of softening in consumer confidence and weak employment growth.



Given strengthening sales and still-low inventories — 51 days' at the end of July, well below the 65 days' that is considered normal, automakers boosted their third-quarter North American production schedules by an additional 76,000 units. This represents a 2.5% increase in production and comes on the heels of a 6.5% jump announced in early July.

Canadian vehicle sales advanced 6% above a year earlier, climbing to an annualized 1.65 million units and lifting volumes at several automakers to the highest level on record for the month of July. This represents the second consecutive monthly rebound from a weak performance in May and indicates that Canadians are once again in a vehicle-buying mood.

CANADA'S BARGAIN-DRIVEN AUTO MARKET

While global car sales have softened over the summer, strong employment growth, as well as enhanced incentives, such as "employee pricing for everyone", have boosted vehicle replacement demand in Canada, helping to lift new vehicle sales to the highest level in nearly three years. In fact, the recent improvement in vehicle purchases have led us to raise our full-year 2010 Canadian sales forecast to 1.565 million units from 1.525 million.

Canadian car and light truck sales strengthened to an annualized 1.62 million units in June and July, up from a weak 1.48 million in May, with volumes buoyed by stronger-than-expected job creation — averaging 43,000 per month in recent months, roughly triple the pace of employment growth in early 2010, and higher incentives by most automakers.

In fact, Statistics Canada indicates that **new vehicle prices have declined by more than 5% since February**, when Toyota introduced their Red Tag incentives as it attempted to attract consumers to its showrooms and offset the impact of massive recalls. However, most of the decline occurred in June and July, as North American automakers launched their "employee pricing for everyone" campaigns.

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Contrary to expectations, enhanced incentives have led to higher, not lower, average vehicle transaction prices, as Canadians take advantage of higher incentives to buy larger and more expensive models. **New vehicle transaction prices have jumped by 5% so far this year — the largest increase since 1996**, following the weak auto market of the first half of the 1990s. For example, while Statistics Canada indicates that incentives reduced new vehicle prices by 1% in June, actual transaction prices jumped by nearly 2% during the month, as consumers shifted purchases from small cars to more expensive vehicles, such as light trucks.

In particular, “employee pricing for everyone” and other incentives, boosted light truck sales 25% above a year earlier in June and July to a record annual rate of 930,000 units, well above the previous high of 830,000 in mid-2007. Pickup trucks — the most heavily incentivized segment, with cash incentives exceeding \$9,000 on some models, nearly 30% of MSRP — drove the surge, with sales climbing nearly 40% so far this year.

In contrast, Canadians are shifting away from small cars, with segment volumes declining 2% yr/yr through July. Small cars traditionally dominate the Canadian market, accounting for one-third of overall car and light truck sales. However, their share has slumped to less than 29% so far this year — the lowest level in more than a decade — and down from a peak of 35% in 2008, when gasoline prices across Canada averaged \$1.20 per litre.

Canadians are not only buying light trucks but are also shifting to mid-size cars — such as the Ford Fusion — the best-selling car in its segment. Purchases of these models have climbed by 6% so far this year, garnering 21% of the Canadian

car market, up from only 19% in 2009. One reason for the behavioral shift is that automakers are currently offering up to \$1,000 higher incentives for the mid-size models than small cars.

We expect this summer’s escalation in incentives to moderate in coming months, as it represents a significant divergence from developments in the United States, where automakers — especially those based in Detroit — have scaled back incentives. Industry data suggest that U.S. inducements have fallen by 4% so far this year, with incentives for light trucks posting the largest decline. We estimate the average inducement to buy a new vehicle in the United States has fallen to about 10% of transaction prices, down from more than 12% in early 2009. In Canada, the current incentive binge ranges from 10% of MSRP for small cars to nearly 30% for light trucks — a level that is clearly unsustainable.

However, even with lower incentives, we expect improving employment prospects after a tough recession to support modest sales gains going forward. Vehicle replacement demand in Canada slumped to only 6% of the vehicle fleet last year, from an average of nearly 7% over the past decade. This boosted the number of vehicles on Canadian roads that are at least 9 years old by nearly 80,000 last year to a record 8.6 million, with many in need of replacement. In addition, even as automakers scale back incentives, we expect them to hold the line on pricing in the new model year, a development that will support industry volumes, as well as more traditional market segmentation. We expect Canadian sales to total 1.59 million units in 2011, in line with the average of the past decade. In contrast, even with some improvement next year, U.S. volumes will still remain 20% below the decade-average.

International Car Sales Outlook

	<u>1990-99</u>	<u>2000</u>	<u>2001-07</u> (millions of units)	<u>2008</u>	<u>2009</u>	<u>2010f</u>
TOTAL SALES	39.20	46.64	49.53	52.17	50.91	54.19
North America*	16.36	19.77	19.36	15.85	12.68	13.92
Canada	1.27	1.55	1.61	1.64	1.46	1.57
United States	14.55	17.35	16.71	13.19	10.40	11.50
Mexico	0.54	0.87	1.04	1.02	0.82	0.85
Western Europe	13.11	14.75	14.57	13.54	13.62	12.25
Germany	3.57	3.38	3.29	3.09	3.81	3.05
Eastern Europe	1.18	2.38	2.54	4.01	3.01	3.25
Russia	0.78	1.03	1.42	2.73	1.47	1.69
Asia	6.91	7.85	10.82	15.07	17.68	20.49
China	0.33	0.61	2.56	5.04	7.31	8.77
India	0.31	0.60	0.81	1.20	1.46	1.82
South America	1.64	1.89	2.24	3.70	3.92	4.28
Brazil	0.94	1.17	1.40	2.23	2.48	2.77

*Includes light trucks.