

# THE IMPACT OF COVID-19 ON THE AUTOMOTIVE SECTOR

EDC Economics

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## SUMMARY

- Complex supply chains offer important strategic advantages to the automotive sector, but they became a key fragility at the start of the COVID-19 outbreak began, making it among the most vulnerable industries to the impacts of the global pandemic.
- Most North American carmakers are currently targeting early-mid May to restart operations. The reopening of assembly operations will be gradual and staggered across jurisdictions given heightened employee safety concerns, the expectation of drastically lower demand, and potential supply chain disruptions.
- What the rebound in the auto sector will look like, as in the broader economy, remains highly uncertain. The COVID-19 shock will delay some car purchases. However, the sector is also highly procyclical, and as such, sales and production activity should exhibit a sharp eventual rebound alongside the aggregate economic recovery.
- Challenges facing Canada's auto sector before COVID-19 are likely to be compounded by increased uncertainty and heightened risks to the location of future production.

## GLOBAL SECTORAL PERFORMANCE

The global automotive sector entered 2020 on relatively solid footing. Annual vehicle demand in the United States—Canada's main export destination—was just shy of the recent cyclical peak and stabilizing around a healthy plateau. The productive capacity of original equipment manufacturers (OEM) with operations in North America had also been gearing up, fuelled by significant investments within a highly competitive technology race to satisfy the significant wave of vehicle replacement needs.

Deep and sophisticated supply chains offered important strategic advantages to vehicle manufacturers and suppliers, but ultimately became the sector's Achilles heel when the COVID-19 outbreak hit. The automotive sector is now considered to be among the most vulnerable to the impacts of the global pandemic. According to S&P Global Ratings, the automotive sector exhibits the highest rating downgrade pressure.<sup>1</sup> In Canada, the auto sector has one of the highest rates of reliance on imports of intermediate goods among all sectors. Normally vehicle suppliers keep at least two months of parts inventory sourced from Asia, and it usually takes between 30 to 60 days to receive new shipments from China to North America. This means that supply chain disruptions in Asia can have significant business implications.

<sup>1</sup>S&P Global Ratings, "Coronavirus Insights: Friday Credit Focus", p. 7, 24 April 2020.

As the virus epicentre rotated—first from China to Europe and then to the U.S.—national lockdowns and stay-at-home orders temporarily shuttered factories and largely kept potential vehicle buyers away from dealership showrooms. Having put in place stringent lockdown measures, China’s roughly 80% collapse in February vehicle sales and production was both a shocking reflection of the impacts of economic paralysis on the sector, the risky degree of concentration and reliance on the Chinese manufacturing sector for parts and supplies, and a frightful harbinger of things to come for the rest of the world as the virus spread.

Prior to implementing their own temporary shutdowns, globalized OEMs and myriad suppliers in Europe and North America faced the daunting prospect of parts shortages originating mostly from China. They also faced the urgency to implement contingency plans to purchase missing components from alternate sources at a higher cost to avoid disruptions to operations.

In Europe, nearly all automotive production plants shut down operations in March, and production data followed a similar trajectory as in China, with April expected to show a larger hit from a full month of lockdown. The European Automobile Manufacturers Association estimates European Union-wide vehicle production losses are tracking at around 2.2 million units<sup>2</sup>, equivalent to about 10% of total production in 2019.

Vehicle assembly plants across North America began implementing temporary shutdowns around mid-March as employee health became a key concern, with OEMs in Canada and Mexico largely following suit. Return-to-work plans are expected to be gradual and staggered across jurisdictions given heightened concerns over employee safety, the expectation of drastically lower demand, and potential supply chain disruptions. Amid the ongoing speculation about the timing for reopening the economy, most North American OEMs are currently targeting early-mid May to restart assembly operations. Global industry analysis by IHS Markit, estimates this timeline would mean a loss of 2.8 million units, equivalent to around 17% of total production in 2019.

On the demand side, annualized new vehicle sales in the U.S. fell to 11.3 million units (-34% month over month) in March, and to just 8.6 million units in April (an additional 24% drop), the lowest level in on record since 1980, reflecting the impact of a full-month lockdown. In all, compared to the last global crisis, the peak-to-trough sales decline is expected to be sharper and swifter this time around. IHS Markit and Wards Automotive currently forecast U.S. sales in 2020 between 12.5 and 12.9 million units, for a decline of roughly 25% compared to 2019, assuming demand rebounds in the second half of 2020.

<sup>2</sup> European Automobile Manufacturers Association,  
[Interactive map: Production impact of COVID-19 on the European auto industry](#)

### The recovery in automotive sector activity will depend on several factors:

- **On the plus side:** The auto sector, including light vehicles, medium-heavy duty trucks, transportation equipment, and vehicle parts, is highly procyclical. As such, sales and production activity should exhibit a sharp, short-term rebound alongside the broader economy. For the light vehicles segment, the COVID-19 shock is likely to delay purchases and as a result it should create new pent-up demand as needs for new vehicles or replacing aging cars shouldn't change because of this temporary shock. In fact, it's quite likely that an initial lingering level of general hesitation to the use of crowded public transportation—and concerns about a second wave next winter—may boost vehicle purchases in the short term. What's more, growing inventories at dealer lots means that prospective buyers will benefit from increased sales incentives, even if these may ultimately be money savers to those who were going to purchase a vehicle anyway. Rock-bottom interest rates will, in turn, further support the rebound.
- **On the negative side:** Consumer attitudes toward visiting dealership showrooms may be impacted by virus fear, however, on the flipside, this is increasing the reliance on online sales. Additionally, the hit to household finances from the massive job losses may result in increased short-term consumer caution toward the purchase of big-ticket items even as the labour market recovers. Plunging prices for the much more affordable used vehicles segment are a further competitive headwind to new vehicle sales. Also, despite the low interest rate environment, bank credit conditions may tighten in the short term given the impact to bank asset quality from the deterioration in household balance sheets.

## DOMESTIC PERFORMANCE

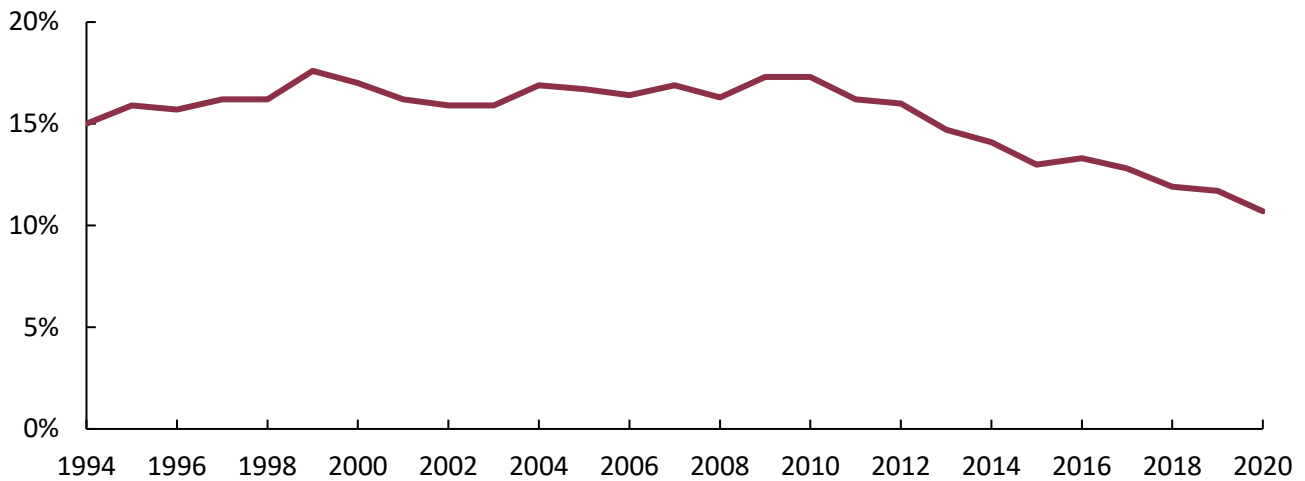
Canada's auto assembly sector has been facing longstanding competitiveness challenges and since 2017, a downtrend in production and a negative outlook. In recent years, the geography of new investments in production capacity expansions for light vehicle assembly has largely benefitted the southern U.S. and Mexico. GM's recent exit from its Oshawa assembly operations is the latest and most high-profile example of Canada's declining share of the North American light vehicle manufacturing pie, which has plunged from 17% in 2010 to around 11% now. Not surprisingly, Canada underperformed in vehicle production in North America for March, which—on a year-over-year basis—tumbled 28% in the U.S., 25% in Mexico and 34% in Canada.

The COVID-19 outbreak risks increasing OEMs' caution and strategic consideration of product mix and geographic plant location, especially as short-term sales and financial performance deteriorate while costly technological investment plans become a heavier burden. Some carmakers may consider revisiting or delaying their manufacturing strategies, which could impact planned new product offerings. The high fixed-cost structure of assembly platforms, the financial strains posed by the current crisis, and elevated competitive pressures may also result in increased sector consolidation, with the planned FCA-PSA Peugeot merger being a likely precursor of more to come. What's more, the current expectation of prolonged depressed oil prices—at least until 2021—a higher cost structure and price tag, and costly investment requirements could be bad news for the further development of nascent technologies like the electric vehicle segment. This would also come at an inopportune time for Canada's research clusters and parts suppliers given the recent focus on becoming a global emerging leader in automotive technologies, such as alternative powertrains (electric vehicles and fuel cells).

For a detailed analysis on the future of automotive technologies, see EDC's forthcoming report entitled *Future of Auto Sector – Post Pandemic*.

SECTOR	GROSS DOMESTIC PRODUCT (DECEMBER 2019)	EMPLOYMENT (2019)	NUMBER OF COMPANIES
<b>MOTOR VEHICLES AND PARTS MANUFACTURING</b>	\$16.0B	134,632	Total: 1,164 SMEs:1,111 Large: 53

## CANADA'S SHARE OF NORTH AMERICAN PRODUCTION OF LIGHT VEHICLES



Sources: Wards Automotive, Haver Analytics

## ABOUT THIS REPORT

This report is part of a publication series of concise reports written by EDC Economics staff on the impact of COVID-19 on Canadian international trade and investment. The views expressed in this report are those of the author and should not be attributed to Export Development Canada or its Board of Directors.

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