3 Factors That Could Work Against the Auto Industry in 2018

Description

Total light vehicle sales fell 1.2% year over year compared to November 2016 according to a recent report from DesRosiers Automotive Consultants. However, year-to-date sales reached 1.91 million compared to 1.82 million in the prior year. In its third quarter GDP report, Statistics Canada showed that exports of motor vehicles and parts were down 9%. Passenger cars and light trucks saw the steepest drop at 11.7%.

The auto industry is facing a number of challenges, as we look forward to 2018. Let's look at three developments investors should keep an eye on.

Auto loan credit is piling up

In November, I'd focused on stocks like **AutoCanada Inc.** (TSX:ACQ) due to the record year in vehicle sales. AutoCanada reported new vehicle sales of 12,014, which represented a 9.4% increase year over year as well as used vehicles sales of 5,118 — up 2.9% from Q3 2016. Finance and insurance accounted for 4.8% of total revenue and 26.2% of its gross profit in the third quarter.

A report in June revealed that loan balance grew 2.8% year over year to $18,783. The 60-day delinquency rate was flat at 1.7% of the loans reported to TransUnion. A large proportion of loans are being granted to prime-plus and superprime-tier borrowers — a 10% and 12% increase, respectively. The OECD released a report in November that showed Canadians are carrying the most household debt in the developed world.

NAFTA hangs in the balance

In a recent note to its investors, the U.S. multinational bank **Goldman Sachs Group Inc.** said that tax reform would do little to improve souring NAFTA renegotiations. The bank called an announcement of U.S. withdrawal "more likely than not." Experts and analysts, who were initially very skeptical of the Trump administration making good on its anti-NAFTA rhetoric, are beginning to recognize the increasing likelihood of an end to the agreement.

Auto industry leaders, including the CEO of Canadian automotive parts manufacturer **Linamar Corporation** (TSX:LNR), have urged caution. The industry has become increasingly intertwined with the three nations, and a disruption of this scale could be a major shock to businesses and consumers.

According to a report from **Bank of Montreal**, the automotive industry in the U.S. and Canada could be one of the hardest hit. Canadian consumers could see automobile prices jump in the short term, which would likely slow down sales. However, Canadian officials appear to be open to the idea of a two-way trade pact with the U.S. if NAFTA is scuttled.

Rising interest rates

Global growth has significantly improved throughout 2017, and central banks are eager to reduce balance sheets as we head into 2018. The Bank of Canada has hiked interest rates twice in 2017 and decided to eschew a third rate hike in December, as it monitors new mortgage rules set to trigger in January. The central bank is also exercising caution due to the uncertain future of NAFTA and record high Canadian household debt.

Most auto loans are set on fixed-rate terms, but some consumers opt for variable-rate plans. Most variable-rate car loans maintain a fixed payment, even as rates rise, but the length of the loan is extended to make up the difference. If growth meets expectations, the Bank of Canada will likely look to make at least two rate moves in 2018.

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