Canadian Vehicle Exporter's Association

150 King Street West
Toronto, Ontario, M5H 3T9
Phone: 1-647-271-5108
Email: info@cvea.ca
Web: www.cvea.ca

# Tariffs on Used Vehicle Exports to the US Could Decimate the Auto Industry in Canada

The terms ‘over-supply’ and ‘negative equity’ may soon become the newest phrases to be assimilated into the lexicon of the daily conversations between Canadians. Like ripples expanding from a pebble dropped into a calm lake or airflow disrupted from the wings of a butterfly, the automotive market in Canada is already on the knifes-edge of a financial storm that was precipitated by the COVID-19 pandemic; it may need only a gentle nudge to be set upon its head. However, when that nudge is from a 25% tariff gorilla, the unintended long-term effects could rage with a ferocity that lingers well beyond the imaginable scope.

Canada stands at the precipice of a trade war with our Southern neighbor which has the potential to decimate the vehicle industry in Canada for vehicle dealers and consumers alike. As a nation based on trade, if a 25% tariff is indeed introduced, the unintended consequences will not only have severe immediate detrimental impacts but may reverberate through the industry long after the dispute is resolved.

360,000 pre-owned vehicles are exported from Canada to the US each year. Estimates have been stated that 25% of pickup trucks, 25% of SUV’s, and 10-25% of cars sold in Canada as new, will eventually be sold in the US as used vehicles.

These numbers are correlated with the favourable exchange rate between the Canadian Loonie and the US Greenback; the downstream beneficial effects for dealers and consumers can't be understated. When a consumer purchases a new vehicle from a dealer, they are often "trading-in" their current vehicle. The valuation the dealer gives a consumer on their trade-in is directly related to the value the dealer can obtain when they resell that vehicle.

A low and relatively stable Canadian dollar has historically allowed Canadian vehicle dealers to feel secure in knowing they can obtain a fair margin selling used vehicles acquired as trade-ins to the large US market. In turn, this security allows the dealer to offer its Canadian consumers a high amount for their trade-ins. This higher value is then applied against the purchase price of the new vehicle creating a better value and lower monthly payment on the new vehicle being purchased by the consumer. The dealer and consumer each benefit from this symbiotic relationship.

Similarly, the negative effect of a 25% tariff on used Canadian vehicles exported to the US cannot be adequately understated. In an industry where margins are often in the single digits, a 25% tariff would immediately end the trade of vehicles from Canada to the US; the consequences for Canadian vehicle dealers and consumers may be incalculable.

On January 21st, every dealer in Canada may wake up to find that their inventory, which they took as high-value trade-ins from their customers, is now worth 25% less than when they went to bed the night before. There is no longer a regular home for these vehicles and the options for these dealers are bleak; sell their

CVEA Canadian Vehicle Exporter's Association

150 King Street West
Toronto, Ontario, M5H 3T9
Phone: 1-647-271-5108
Email: info@cvea.ca
Web: www.cvea.ca

inventory at a substantial loss or hold the inventory with the hope of a protracted trade war until the US market is once again a viable option. Neither of these options is appealing.

On January 22nd, a consumer enters a dealership to purchase their next vehicle. How does the dealer value that trade-in now? Their entire inventory is already overpriced and their prospects to sell those vehicles, even at cost, are remote. From a financial standpoint, the dealer cannot assume any further risk. The dealer is now forced to offer their potential customer a lower value for their trade-in. With the lower value of the trade-in, the customer may not be able to afford the new vehicle they came to buy.

These scenarios are not hypothetical. Dealers understand that the Canadian used vehicle market can only absorb a finite number of vehicles within the marketplace in order to maintain long-term financial viability from the supply and demand perspective. Due to the risk of financial ruin which could come from a 25% tariff, vehicle dealers who export their used trade-in vehicles to the US have already begun to limit their intake of new inventory.

Though the pandemic may be fading from the collective memory, the lingering effects within the automotive industry are still very much entrenched. Between 2020 and 2023 the average cost of new passenger vehicles increased by 50%, with SUVs and trucks increasing by 25%. For cash-strapped consumers to bear these price increases, many had to resort to accepting extended amortization periods to ensure they could obtain an affordable monthly payment. By the end of 2023, nearly 60% of new vehicle loans had terms of 7 years or greater.

The specter of a negative equity bubble has been permeating the conversation of those in the automotive field for several years now, and this conversation is directly related to the massive increases in costs consumers have absorbed in their vehicle purchases over the last 4 years. Some estimates state that 50% of consumers trading in their current vehicles owe more on their current loan than the current value of the vehicle. This problem will only be exacerbated by the imposition of the 25% tariff as the relatively high current value of those trade-ins will immediately be reduced.

This will set off a further cascading of vehicle prices across the country. The negative equity position of consumers will be such that purchasing a new vehicle will not be financially viable. Unable to sell new vehicles, OEM dealers will see their inventory grow well beyond the normal operating levels that allow them to be profitable.

Canada is a nation based on trade and vehicle dealers in Canada count on sales of used vehicles to the US market as a means to keep the overall costs of vehicle ownership low for everyday Canadians. At a time when vehicle markets are finally starting to recover after years of supply and price issues, a trade war with the US has the potential to wreak havoc on the thousands of dealerships across Canada, the tens of thousands of employees working at those dealerships, and of course, all Canadians who are so dependent on a functional and affordable vehicle market.