

PERSPECTIVE

Trade between Quebec and the United States

Banking on each party's strengths

20% of Quebec's GDP depends on exports to the United States

Now that we are witnessing a changing of the guard at the White House, rising protectionism and a weak Canadian dollar, we might well wonder what trend will dominate bilateral trade between Quebec and the United States in the years to come. It's hard to say, since the uncertainties are multiplying. Our American neighbour buys over 70% of Quebec's international exports, so we feel a shiver down our collective spine when we hear talk about renegotiating the North American Free Trade Agreement (NAFTA). But a portion of this bilateral trade consists of movements of goods between plants of a given company that has operations on both sides of the border. Questions need to be asked about the feasibility of replacing all the Quebec products that are used as input for goods labelled "Made in USA." Trade with the United States is a worrisome issue. It is not in great jeopardy this year, apart from the softwood lumber sector. The tone for the years ahead will depend on the outcome of negotiations. Digging our heels in too quickly would prevent us from shedding light on the assets that each party brings to the table. What is there to gain by failing to capitalize on each party's strengths?

Bilateral Quebec–United States trade in 2016

The year 2016 is officially over, but the statistical year always winds up a bit later. Still, the data from the first 11 months of 2016 are available, and they give us a good idea of the recent trend in bilateral trade. Despite the fact that the Canadian dollar has been flagging, Quebec exports in current dollars have shrunk by 3.5% if we compare the value of goods exported in the first 11 months of 2016 with the same period of 2015. In particular, we note declines in shipments of aluminum, aircraft, paper and electricity.

At first glance, this finding is disappointing. However, when we analyze the data more closely, we see that the beginning of the year was particularly tough; at the end of the first six months, the decline observed was as much as 8.7%. The slump in trade was noted in all the major regions of the United States with the exception of the South Atlantic region, including Georgia and Florida.

Ending the year 2016 on a positive note would require a spectacular turnaround, which is not expected. It is worth

mentioning that 2016 comes on the heels of a few years of quite vigorous expansion of exports to the United States (2013: 6.8%, 2014: 13.0% and 2015: 12.3%).

If we look at our imports from our southern neighbour, the decline was even sharper: 12.3% when we compare the first 11 months of 2016 with the same period of 2015. The drop in imports of conventional crude oil, the price of which fell significantly last year, was particularly noteworthy. In the end, the trade balance has been positive for Quebec so far, and it has even grown compared with 2015. If that trend continues, it could come in at around C\$24B to C\$25B (in current dollars) in 2016.

Recent trading history

Quebec's trade with the United States is not a new phenomenon. We shall refrain from compiling a complete history of this trade, but it is worth taking a look at the past 10 years. Back in 2006, the United States accounted for 77.6% of Quebec's international exports and 30.6% of its international imports. In 2016 (11 months), the relative weight of the U.S. came in at 71.5% of exports and 34.7% of imports.

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The ties are closer for exports than they are for imports. The relative share of the United States has oscillated up and down in recent years, briefly slipping below the 70% mark and then surpassing it a little. Despite these fluctuations, one fact remains: Quebec is heavily dependent on trade with the United States.

Graph 1 shows the recent trading trend and the changes in the trade balance, which remains in Quebec's favour. In 2006, before the recession, the value of exports was

C\$56.8B (in current dollars); that level was surpassed in 2015, when it reached C\$59.5B. In 2016, it will be in the neighbourhood of the figure reached in 2006.

Imports eroded considerably in 2015 and 2016, in particular due to the slump in energy prices, as we mentioned earlier. More specifically, the value of imports of conventional crude oil fell by 37% in 2015 and by around 55% to 60% last year. That product is at the top of the list of goods imported from our southern neighbour.

Our trade with the United States is of strategic importance due to its scope, the longevity of this trading relationship, the geographic proximity (markets are easily accessible by road, rail, sea and air, and we share a common border), the complementary nature of the two economies and the even higher potential for economic growth south of the border, compared with Canada and Quebec. The United States is Quebec's largest trading partner outside Canada. Over 50% of all Quebec exports (interprovincial and international combined) are bound for that market. While that country's share of Quebec's imports is smaller, it is still nearly three times larger than that of the province's second largest trading partner, China.

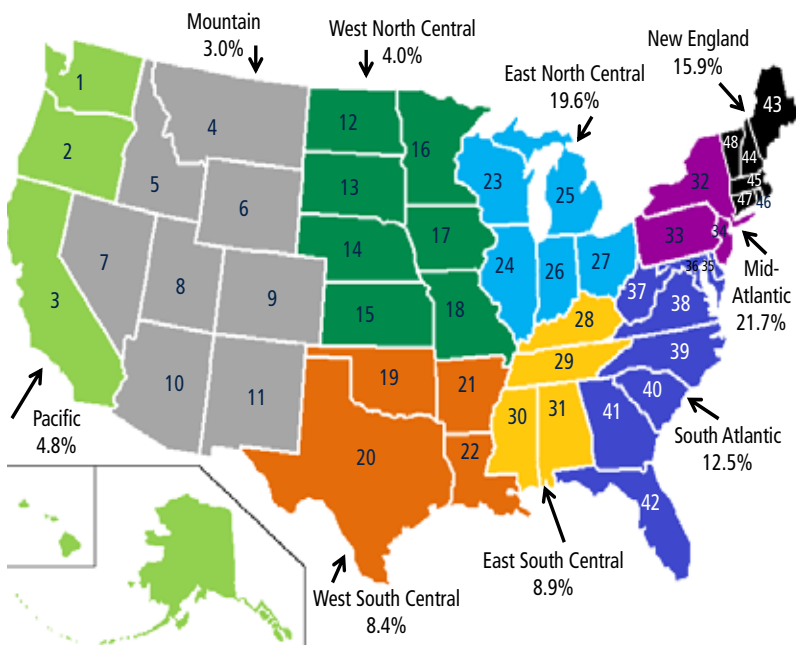
GRAPH 1
Quebec exports to the United States have surpassed pre-recession levels



Sources: Datastream and Desjardins, Economic Studies

MAP 1

Distribution of Quebec exports to the United States by region in 2015



- Pacific: 4.8%**
 Hawaii - Alaska - Washington (1) - Oregon (2) - California (3)
- Mountain: 3.0%**
 Montana (4) - Idaho (5) - Wyoming (6) - Nevada (7) - Utah (8) - Colorado (9) - Arizona (10) - New Mexico (11)
- West North Central: 4.0%**
 North Dakota (12) - South Dakota (13) - Nebraska (14) - Kansas (15) - Minnesota (16) - Iowa (17) - Missouri (18)
- West South Central: 8.4%**
 Oklahoma (19) - Texas (20) - Arkansas (21) - Louisiana (22)
- East North Central: 19.6%**
 Wisconsin (23) - Illinois (24) - Michigan (25) - Indiana (26) - Ohio (27)
- East South central: 8.9%**
 Kentucky (28) - Tennessee (29) - Mississippi (30) - Alabama (31)
- Mid-Atlantic: 21.7%**
 New York (32) - Pennsylvania (33) - New Jersey (34)
- South Atlantic: 12.5%**
 Delaware (35) - Maryland (36) - West Virginia (37) - Virginia (38) - North Carolina (39) - District of Columbia - South Carolina (40) - Georgia (41) - Florida (42)
- New England: 15.9%**
 Maine (43) - New Hampshire (44) - Massachusetts (45) - Rhode Island (46) - Connecticut (47) - Vermont (48)

Sources: Statistics Canada, Institut de la statistique du Québec and Desjardins, Economic studies

Destination: United States

For a clear view of the value of trade with the various regions of the United States, map 1 on page 2 shows how Quebec's exports are distributed. In 2015, four major regions stood out. The first is the Mid-Atlantic region, including the State of New York, Pennsylvania and New Jersey. Those three states alone accounted for 21.7% of Quebec shipments to the United States in 2015. Next comes the East North Central region, which took in 19.6% of Quebec exports in 2015; it includes the states of Ohio, Illinois and Michigan to name just a few. In third place is New England (15.9%), which includes Vermont and Connecticut. Lastly, the fourth region is the South Atlantic (12.5% in 2015), which includes Georgia and Florida, for example.

These markets are in fairly close geographical proximity to Quebec, although there is some terrain to be crossed to reach the more southern states, including Florida. Of the 50 American states, the one that carries the most weight in terms of the value of Quebec exports is the State of New York (table 1). Sales of aluminum products top the list, followed by the smelting and refining of non-ferrous metals. The state of Texas ranks second, in particular due to shipments of aerospace products and parts. Bombardier has several types of facilities there, including a service centre and a component repair and overhaul centre.

TABLE 1
Top 10 states for Quebec exports

RANK IN 2015	STATES	EXPORTS	CHANGE (%)
		\$B in 2015	11 months 2016 vs 11 months 2015
1	New York	6,876.0	-3.1
2	Texas	4,997.4	-10.8
3	Ohio	4,537.6	-3.6
4	Pennsylvanie	3,650.0	-3.1
5	Vermont	3,086.0	-11.4
6	Tennessee	3,085.6	-25.7
7	Connecticut	2,634.7	-12.9
8	New Jersey	2,395.0	0.2
9	Illinois	2,354.4	-0.6
10	Michigan	2,107.2	-3.0

Sources: Statistics Canada and Desjardins, Economic Studies

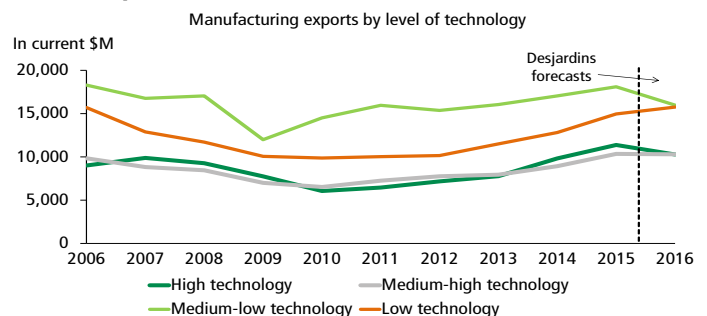
Ohio stands in third place, and exports of aerospace products and parts top the list. Heroux Devtek, which produces landing gears, has facilities there. Pennsylvania comes fourth, due in particular to alumina and aluminum products, followed by shipments to pulp and paper mills. In fifth place, Vermont stands out mainly for its purchases of semi-conductors and other electronic components. Naturally, the IBM plants in Bromont and Burlington are in close contact with each other and contribute to this ranking, where electronic products take centre stage.

In 2015, the number one product sold by Quebec to the United States was aircraft, accounting for 9.4% of the value of exports to that country. Shipments of aluminum and unwrought aluminum alloys followed close behind that year, with a share of 9.1%. This means that 18.5% of Quebec sales to the U.S. depended solely on these two types of products. If we add up complete aircraft, parts and engines, we can see that they represented 12.7% of the value of exports to the United States, i.e. one out of every eight export dollars.

The long march towards technology

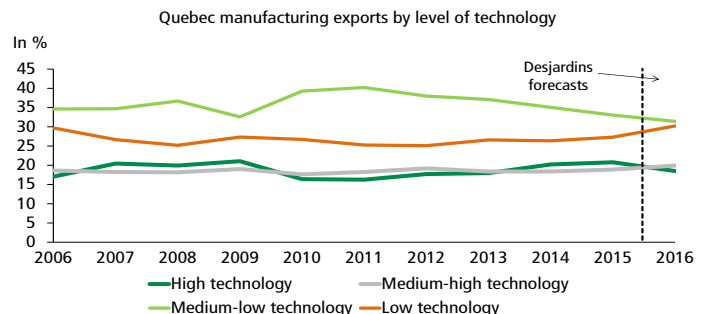
A brief look at exports according to technological level offers a different perspective and produces a few quick findings. Graphs 2 and 3 show that shipments of products in the medium-low technology category (refined petroleum products, rubber and plastic, non-metallic mineral products and basic metal products, for example) and low technology products (paper, cardboard, wood, food and beverage, textiles, clothing and recycling, for example) have been dominating for years. They lead in terms of both value and percentage of exports.

GRAPH 2
Medium and low-technology goods still dominate Quebec exports



Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 3
The relative positions of the various technological categories of goods exports have not changed much



Sources: Statistics Canada and Desjardins, Economic Studies

We also note that, over time, the value in current dollars has not changed much between 2006 and 2016, suggesting that, in constant dollars, the value of Quebec exports to the United States has declined. Moreover, we know that Quebec and Canadian products have gradually lost their share of U.S. imports since 2002, to the benefit of the emerging economies.

In 2016, we have noticed a downturn in the value of shipments in the high technology (-6.9% after 11 months) and medium-low technology (-10.1%) categories. Stability has been observed in medium-high technology, and a rise in low technology (5.2%). In that same year, we saw declines of nearly 14% in exports in the aeronautic and aerospace category and approximately 11% in the office and computing machinery sector. In the medium-low technology category, there was a clear slump in coking products and refined petroleum products (approximately 45%).

The other side of the coin: imports

While the United States is a prime destination for Quebec exports, it is also a significant supply source. The top-ranking imported goods change over time, all the more so recently due to falling energy prices.

For example, conventional crude oil, which was still the number one import from the U.S. in 2015, slipped to third place in 2016. The ranking (in decreasing order) in 2016 was as follows: light trucks, minivans and sport-utility vehicles in first place, nearly even with passenger cars. Next comes conventional crude oil, followed by aircraft parts and other aerospace equipment, followed by printed and integrated circuits, semi-conductors and circuit assemblies. It should be noted that the value of imports from the United States was approximately half that of exports in 2016.

Question mark for the future

In recent years, international exports have accounted for between 27% and 28% of Quebec's GDP. Given that around 70% of those exports were bound for the United States, we can estimate that shipments heading to the U.S. market represented between 19% and 20% of Quebec's GDP. That is considerable. Around 4,500 Quebec firms export regularly to the United States, according to Quebec's Ministère de l'Économie, de la Science et de l'Innovation (MESI).¹

Once that finding is established, and given all the factors that can unsettle trade relations between two governments, is it possible to predict future trends in exports to the United States? It would be a perilous exercise, since the current economic and political conditions are fraught with uncertainty. However, it would be worthwhile to review the factors that could influence Quebec shipments to the United States.

One of the factors that could favour exports to the United States is U.S. demand. In this regard, we already know that in the third quarter of 2016 (that is, before the outcome of the presidential election was known), the U.S. economy had picked up steam. Despite a more modest fourth quarter, consumer and business confidence is on the rise, giving us hope for a somewhat better performance in 2017. If the new president's promises of lower taxes and infrastructure investments were implemented quickly, the U.S. economy would receive an extra boost which, at first, would be favourable to Quebec exports. However, Quebec firms have no influence on this component of the equation.

The current weakness of the Canadian dollar could have a salutary effect on Quebec exports. In all probability, the loonie could fluctuate between US\$0.70 and US\$0.75 at the end of 2017, and would appreciate slightly at the end of 2018. These are beneficial conditions for firms on this side of the border but, again, this is a factor over which they have no control.

Lastly, there is at least one other aspect to consider: American firms' awareness of our products. If we want to sell to the United States, we need to be seen and recognized. This is a factor that we can act upon.

Actions in that direction have been taken in the past and, more recently, in October 2016, the MESI launched a new export strategy for 2016–2020. Over half a billion dollars will be invested to implement it. It will comprise 21 action items to conquer foreign markets, including the United States.² These action items involve business strategy, expertise, foreign certification, use of e-commerce, supply chain integration and the showcasing of innovative products from Quebec firms. These efforts are combined with those of numerous federal agencies aimed at promoting Canadian exports and know-how abroad.

¹ Ministère de l'Économie, de la Science et de l'Innovation, *Oser exporter*, Stratégie québécoise de l'exportation 2016-2020, Cap sur les États-Unis, October 2016.

² *Ibid.*

Headwinds

The above-mentioned factors are those that could support sales of Quebec products in the U.S. market. However, headwinds could lessen their effect. The rise of protectionism is something that bears watching. Measures intended to deter the entry of foreign products are nothing new, but it cannot be denied that protectionist rhetoric and actions are becoming more prevalent around the globe, and North America is no exception to this phenomenon.

Other factors could hinder the smooth flow of trade. The desire of some industry leaders in recent years to repatriate a portion of their production to their plants on U.S. soil to serve the North American market is one such factor.³ The new U.S. president's determination to renegotiate NAFTA in the short term in favour of American interests is another, and it is very worrisome.

During these discussions, which are likely to be intense, what parameters will be reviewed? What will the negotiations be based on? Before we sound the death knell for Quebec exports to the United States, there are some questions we can ask. Will U.S. firms' economic rationale on the subject of controlling production costs disappear in a flash, when the Canadian dollar is trading closer to between US\$0.70 and US\$0.80, providing significant savings?

Should we put credence in information that is circulating about the imposition of a 10% border tax that would increase the cost of goods imported from Canada? There is no certainty on that point.

We must keep in mind that the feasibility of replacing one good with another is not the same in all spheres of activity. Moreover, supply chains are increasingly common, and they open the door wider to foreign products than before. Added to that is the fact that a portion of Quebec's transborder trade arises from firms that have plants on both sides of the border; that share was estimated at between 30% and 50% in the 2000s.

At time of writing, all this remains to be clarified. We must also remember that Canada is the top trading partner of 35 U.S. states, and that not all of them are ready to throw in the towel so quickly (map 2).

MAP 2

United States: Canada is still the main trading partner in terms of exports



*Including: Hong Kong, Switzerland, France, Brazil, Australia and Belgium.
Sources: The Globe and Mail and Desjardins, Economic Studies

On the other hand, we cannot sweep under the rug the softwood lumber dispute and the imminent sanctions that will slow down lumber exports south of the Canadian border. In this case, the threat is more immediate and will materialize in 2017.

Lastly, to what extent will Americans' vague protectionist impulses toward other trade partners put Canada in a delicate position? Will the country be stuck between a rock and a hard place?

Keeping watch on the horizon while the fog grows denser

What path will Quebec exports take in the future? In the short term, the renewed strength of U.S. demand will jolt Quebec exports. NAFTA cannot be shelved this winter, because the U.S. president is required to give six months' notice. However, it is clear that a unilateral decision to abandon the Agreement, followed by a raising of U.S. tariffs and the closure of certain markets, would make things difficult for a large number of Canadian and Quebec exporters.

Given the U.S. market's strategic importance to Quebec and Ontario, these two provinces would be hardest hit. The most severe scenarios even suggest a recession. However, the negotiations are not over and we must avoid jumping to conclusions prematurely. The United States and Quebec share a long tradition of trade. Digging our heels in too quickly would prevent us from shedding light on the assets that each party brings to the table. What is there to gain by failing to capitalize on each party's strengths?

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³ Desjardins, Economic Studies, *Perspective*, "The repatriation of manufacturing: beyond the rhetoric", Volume 24/February 2014, 5 p.