

# ECONOMIC VIEWPOINT

## Why Is Quebec's Economy Trailing the Rest of Canada's?

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For some time now, Quebec's economic data has consistently come in weaker than the data for Canada as a whole. Despite a highly diversified industrial structure that typically works to its advantage, Quebec's economy has underperformed so far this year. The benefits of the post-pandemic rebound in auto production and the strength of the oil sector are concentrated in other provinces. In addition, this year's wildfires hit Quebec's economy particularly hard since the province is the country's main forestry producer. All of the above have resulted in a gloomier economic outlook for Quebec than for the entire country in 2023. The province's less favourable demographic trends have certainly held it back. But in this *Economic Viewpoint*, we identify factors in Quebec's major industrial sectors that widen the gap.

### Quebec's Economy Has Slowed Down

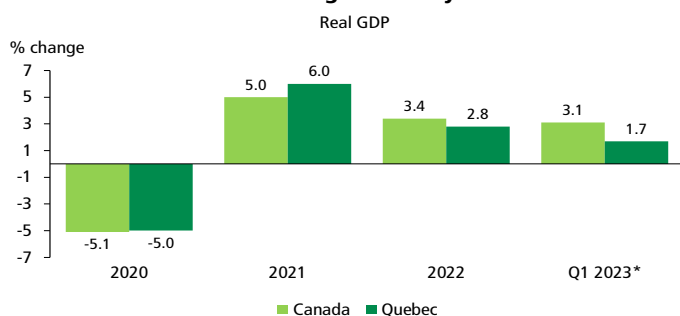
Despite a few hiccups due to differences in public health measures across Canada, Quebec's economy more or less kept pace during the pandemic. But the province has lagged since the year began (graph 1). In the first quarter, real GDP grew at an annualized 1.7% versus 3.1% for Canada as a whole, due largely to lacklustre exports. However, the province's business investment and consumer spending managed to keep up with the entire country's over the period. Even though quarterly figures can only give us a snapshot of a particular point in time, the sustained weakness of many industrial sectors over the past few months confirms the sluggishness of Quebec's economy.

Quebec's [monthly real GDP](#) by industry has slowed considerably since the year began and dropped in April (graph 2). From January to April 2023, Quebec's cumulative growth came in at 0.9% compared to the same period last year. Meanwhile Canada as a whole posted a 2.3% gain. Given this slow start to the year and limited potential for improvement in the short term, our most recent [forecasts](#) place Quebec at the bottom of the provincial ranking for 2023.

### Which Sectors Are Holding the Province Back?

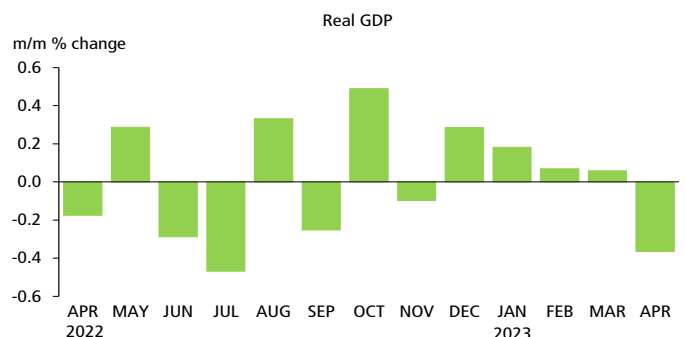
In terms of industries, a look at the first 4 months of 2023 makes it clear that the relative weakness of Quebec's economy

**GRAPH 1**  
The Growth Differential between the Quebec and Canadian Economies Has Been Increasing since Early 2023



\*Annualized quarterly change.  
Sources: Institut de la statistique du Qu bec, Statistics Canada and Desjardins Economic Studies

**GRAPH 2**  
Quebec's Economy Is Sluggish

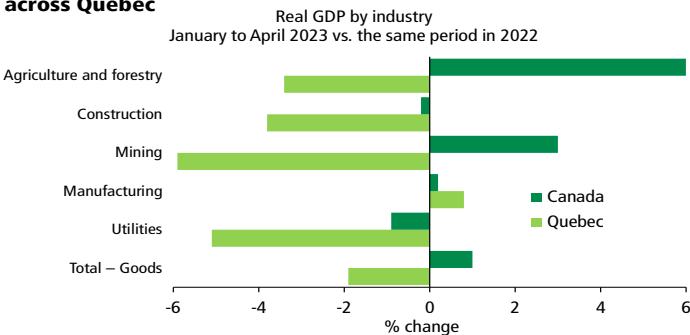


Sources: Institut de la statistique du Qu bec and Desjardins Economic Studies

is coming from both goods and services. Over that period, goods output shrank 1.9% in Quebec compared to the same time last year, while growing 1.0% in Canada as a whole. The province's results were significantly weaker across almost all goods-producing sectors (graph 3). The construction industry and mining, oil and gas are down sharply in Quebec. The oil sector boosted the economies of some oil-producing provinces, which also lifted the numbers for Canada as a whole.

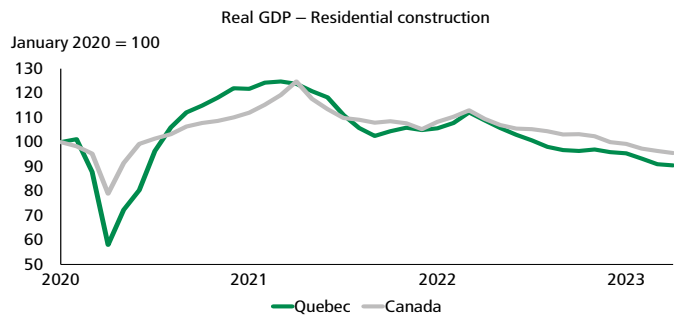
A look under the hood of GDP by industry reveals that residential construction activity fell by 11.9% in Canada and 14.8% in Quebec over the first 4 months of the year. Despite the pickup in demographic growth that is driving up demand for new units nationwide, residential construction ticked lower (graph 5). Restrictive interest rates and high building costs have made new housing projects cost prohibitive for developers. That's why building permits are down even though the housing market remains relatively tight.

**GRAPH 3**  
**There's Broad-Based Weakness in the Goods-Producing Sector across Quebec**



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

**GRAPH 5**  
**Residential Construction Is Cooling in Quebec and across Canada**



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

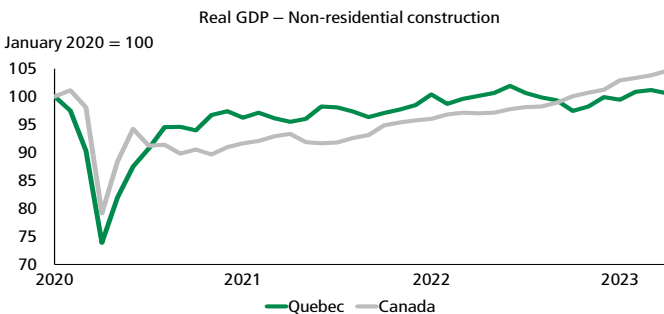
**A Different Dynamic in Construction**

Meanwhile non-residential construction, which is twice the size of the residential sector, is the source of the Quebec construction industry's underperformance. Non-residential construction has grown much more slowly in Quebec than in Canada as a whole since early 2023. Quebec spends a great deal on infrastructure, but a number of other provinces have recently ramped up their spending, while also benefiting from major industrial projects. However, non-residential construction recovered much faster in Quebec after the initial shock of the pandemic. The lag in comparison to the whole country is a relatively recent development (graph 4).

**The Outsized Impact of Manufacturing**

Canada's Ontario-based automotive industry continues to recover as global supply chains return to normal, driving economic growth nationally. Vehicle and parts production climbed 18.3% from January to April 2023 compared to the same time last year. This momentum should last till the end of the year as inventory remains below pre-pandemic levels. Auto and parts production represents approximately 8% of Canada's manufacturing sector. Quebec is home to a number of auto parts suppliers, but the industry's presence in the province remains rather limited. It therefore provided less of an economic boost in Quebec than elsewhere. But some of Quebec's leading industries are on the upswing, including the aerospace sector, which is one of the province's top exporters. Aerospace output was up 7.8% in the first four months of the year compared to the same period of 2022. The post-pandemic recovery in this sector is juicing the economy in Quebec, but less than the auto industry is in the rest of Canada, especially Ontario (graph 6 on page 3). The aerospace sector accounts for around 10% of manufacturing in Quebec and just 3% nationwide.

**GRAPH 4**  
**Non-residential Construction Has Lost Momentum in Quebec, but Is Still Growing in Canada as a Whole**

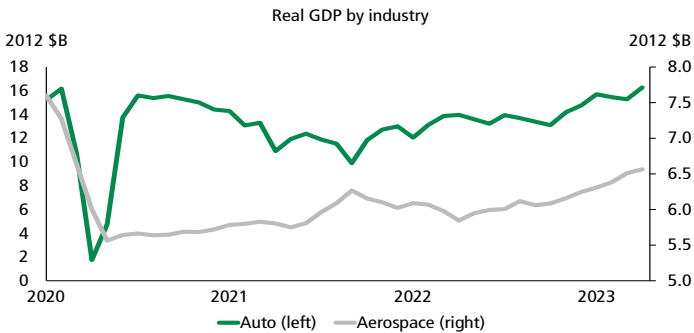


Sources: Institut de la statistique du Québec, Statistics Canada and Desjardins Economic Studies

**Wildfires**

Over the very short term, the impact of this year's wildfires on the logging, wood processing and pulp and paper industries will take a particularly heavy toll on Quebec's economy. These industries serve as the economic lifeblood of many Quebec communities and generate a larger share of provincial GDP than

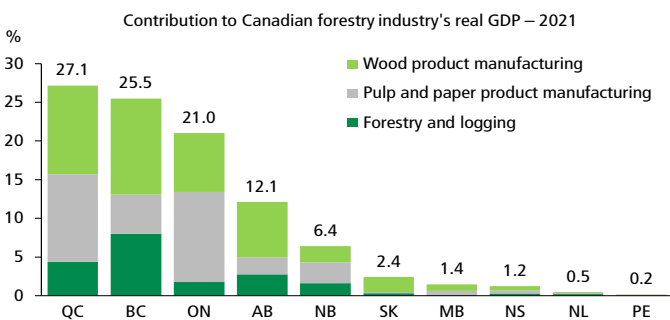
**GRAPH 6**  
Canada's Aerospace Sector Is Bouncing Back Slower than Its Auto Industry



Sources: Statistics Canada and Desjardins Economic Studies

in other provinces (graph 7). Quebec's forestry sector accounts for nearly 8% of jobs and 12% of exports in goods-producing industries. We still don't know how much this will affect real GDP figures, nor how much the damage caused by the wildfires will stall the recovery of these industries in the affected regions. So far we only have data up to April, just before the wildfires began, shutting down multiple factories and forcing the evacuation of certain affected regions. The wildfires also hit other industries like tourism and mining. The next data release will detail the full impact on Quebec's economy. Other provinces that were impacted by wildfires, such as British Columbia and Ontario, will also feel the economic toll.

**GRAPH 7**  
Quebec Contributed the Most to Total GDP For the 3 Main Subsectors of Canada's Forestry Industry

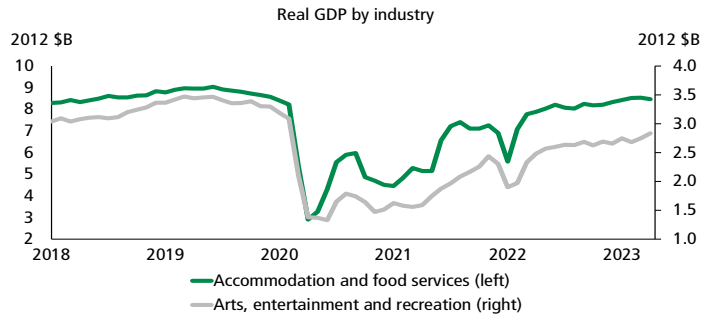


Sources: Natural Resources Canada and Desjardins Economic Studies

**Localized Weakness in Services**

Services were up 1.9% in Quebec, well below the 2.8% growth seen nationwide over the first 4 months of the year. But we aren't seeing this weakness across all of Quebec's service sectors, some of which are even outpacing Canada as a whole. For example, entertainment, accommodation and food services are still recovering in Quebec following repeated restrictions and shutdowns during the pandemic (graph 8). Consequently, they're growing at a faster clip than in the country as a whole.

**GRAPH 8**  
The Sectors Hit Hardest by the Pandemic Continue to Recover in Quebec



Sources: Institut de la statistique du Québec and Desjardins Economic Studies

Sluggish wholesale trade is the main factor weighing down the service sector. Aside from agricultural and food products, which have reported stronger gains in Quebec, all other categories are down more sharply in the province. Is this a sign that consumer spending will slow and have a bigger impact in Quebec, or does it just reflect higher inventory levels that are dampening wholesaler purchases? It's hard to say, as retail trade has been growing faster in Quebec than in the country as a whole since early 2023. Quebec households are in a better place financially, which is a plus for consumers. But a more significant downturn in the job market and slower population growth than elsewhere in the country are more negative factors.

**Will This Lag Last?**

The weakness of Quebec's economy since early 2023 is expected to continue for a few more quarters. Most goods-producing industries have already started to slow with no signs of picking up in the near term. Due to its industrial structure, Quebec isn't riding the tailwinds of the automotive rebound or the strength of the oil sector. The ongoing recovery of the aerospace industry isn't enough to make up for that. And non-residential construction isn't as robust in Quebec as in all of Canada, where several provinces are making massive investments in infrastructure. The wildfires will hit Quebec particularly hard since they directly affect a number of major industries. We therefore expect the provincial economy to cool in the short term before starting to heat up again in 2024.

The growth engines that have driven the Canadian economy to outpace Quebec's will have lost some steam by then. The mounting difficulties facing the global economy will sap momentum from the oil sector, while the auto industry will slow once inventories have been replenished and demand for vehicles in North America has died down. But the Big Three are currently in contract talks with unions, which could mean production disruptions if employees go on strike.

In addition, unusually rapid demographic growth in many provinces is expected to ease up. This will put less pressure on a number of sectors, especially services, which depend on consumer demand. After starting 2023 with a bang, the Canadian economy has begun to slow and should soon enter a period of contraction. That means both Quebec and Canada should eke out positive growth in 2024, closing the gap that emerged in 2023. This year we expect growth to come in at 0.4% for the province and 1.7% nationally.

### **Implications**

Quebec's underperformance suggests that its economy is slowing down faster than the country as a whole and could dip into a mild recession just ahead of its peers. This will probably ease the province's more persistent inflationary pressures fairly soon. The government may be tempted to provide additional economic stimulus depending on how much conditions deteriorate. But it should think twice, as the Bank of Canada hiked interest rates in June and July to further tamp down on inflation. Since the economic downturn is expected to be mild, the government should stay focused on improving more structural drivers such as productivity, private investment and housing construction.