The trade deficit weighs down Quebec’s economy

Quebec’s foreign trade has fallen on tough times since the beginning of this century. The causes of this deterioration are plentiful. Massive imports of Chinese products have quickly inflated the province’s trade deficit. The two U.S. recessions and the appreciation of the Canadian dollar have also exacerbated the problems facing foreign trade. The trade surplus with the United States has narrowed because several structural and economic factors have taken their toll on Quebec’s exports. Many sectors have been struggling over the past 10 years or so, especially the forest industry and telecommunications equipment.

Even if more favourable economic conditions stimulate exports from next year onwards, this will not be enough to wipe out the trade deficit. The causes of this profound malaise are too deep-seated, and a new trade dynamic is firmly entrenched. Unless the province sets out to conquer the emerging markets, which offer greater growth potential than the industrialized countries, exports will not gain enough ground to cancel out the trade deficit. That deficit now stands near a record level and is putting a damper on the province’s real GDP growth. It seems that the Quebec economy will continue to have this millstone around its neck for many years to come.

Graph 1 – The size of Quebec’s trade deficit is worrisome: the turning point came in the early 2000s

Quebec has seen other periods in the past when the international merchandise trade balance was in the red. In the 1980s, the gap between exports and imports was slightly negative. Starting in 1994, the province’s commercial trade saw a period of surplus following the entry into force of NAFTA (North American Free Trade Agreement). This stimulating effect on our shipments abroad faded away at the beginning of the millennium. Imports advanced faster than exports due to several factors, both economic and structural (box page 4). The increased penetration of Asian products, particularly from China, in our market stimulated imports just when hurdles began multiplying for Quebec’s exports, which began a long period of decline from their peak of around 10 years ago. Consequently, the goods and services trade balance fell into negative territory (graph 1), and then gradually worsened until it set a new record in 2011. The trade deficit widened for both goods and services. The merchandise component accounts for nearly 80%, while services play a more limited role in the province’s trade.

The trade balance shown in graphs 1 to 3 refers to trade in goods and services based on economic accounts. Since exports by country are available only for merchandise, the graphs and the analysis by geographic area pertain exclusively to products, and exclude services.

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The burden of the foreign trade deficit has grown over the years (graph 2), hindering Quebec’s real GDP growth. Considering the size of the economy, the trade deficit is now twice as large as it was in the 1980s. The profound changes in global trade in the past 10 years have had major repercussions for Quebec.

Conversely, exports abroad declined from 2007 to 2012, from $95B to $90B, just when imports were soaring. Thus the trade deficit grew quickly due to the deterioration of trade with foreign partners. Can certain geographic areas be singled out in this regard?

**CHINA HAS PLAYED A CRUCIAL ROLE**

Trends in Quebec’s merchandise trade have been largely influenced by the manufacturing boom in China (graph 4). The surge in imports from China has quickly propelled that country to the rank of top supplier of consumer products to the United States. Naturally, this upheaval has reduced the opportunities for Quebec businesses, exacerbating the deterioration of the trade balance with China (graph 5). In 2012, the trade deficit in goods with the Middle Kingdom was more than 6 billion dollars, i.e. approximately one quarter of the deficit with all countries.

**INTERPROVINCIAL TRADE IS HOLDING ITS OWN**

Quebec engages in commercial trade both with the other provinces and with foreign countries. Therefore, the province’s trade balance depends on the dynamics of both domestic and foreign markets. Quebec’s trade balance with the rest of Canada has fluctuated very little in the past 30 years: on average, it is practically nil. While it showed a slight deficit at the beginning of this century, it now has a bit of a surplus (graph 3). Exports to the other provinces have expanded greatly in the past five years, from $60B to nearly $75B, enabling Quebec to eke out a slight surplus from interprovincial trade.

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THE TRADE SURPLUS WITH THE UNITED STATES HAS DIMINISHED

Developments in trade with China were not alone in doing damage to Quebec’s trade balance. The trade deficits with Europe, Asia and Africa have expanded in the past 10 years, while that with South America has remained practically flat (graph 6). The merchandise trade balance with the United States has stayed positive, however. But while the surplus was in the neighbourhood of $30B in 2002, it has been halved since then. This means that the surplus gained from our American neighbours is no longer large enough to balance out the growing deficit with the other zones, such as Europe and Asia. The safety valve provided by trade with the United States is no longer sufficient. Without a revitalization of our trade with that country, Quebec’s trade balance is likely to remain in negative territory for a long while to come.

Unfortunately, exports of goods to the United States have not stopped losing ground since the early 2000s. The fact that China has conquered the U.S. market and stolen the title of top supplier, at the expense of Canada, which formerly held that position, has considerably reduced the province’s market share. Quebec now exports less than 70% of its products to the United States, compared with over 85% a decade ago (graph 7). Meanwhile, trade with other destinations such as Europe, Asia and elsewhere has expanded, evidence of some degree of global diversification (graph 8). But even though the value of exports overseas has almost doubled in the past 10 years, from $11B to $20B, this has not been enough to offset the approximately $15B lost in trade with the U.S. market (graph 9). Result: Quebec’s total international merchandise exports have been eroding since the beginning of this century.
The drop in exports of goods is due to numerous hurdles that have reduced our trade with our American neighbours (table 1). The bursting of the technology bubble and the recession of 2001 in the United States first put a halt to a long period of growth in exports (graph 10). At the end of the 1990s, the telecommunications equipment industry was flourishing in Quebec. The value of shipments abroad reached $12B, making this our top export product. The bankruptcy of the main pillar of that era, Nortel, quickly sent production in that industry tumbling.

The structural factor that has had the greatest global repercussions is without a doubt the increased penetration of Chinese products in the United States. Quebec exporters found it more and more difficult to sell their products on the U.S. market as the supply chains turned their sights on Asia. The proportion of shipments bound for the United States fell quickly. The U.S. is still our main trading partner, but its importance has definitely crumbled since the beginning of this century.

Other factors have also left scars. Global competition has triggered a wave of rationalization in the pulp and paper industry and in the textiles and garment sector. Many plants have closed, thereby reducing our ability to sell abroad. Of course, the rapid appreciation of the Canadian dollar (graph 11) has certainly complicated things, and the majority of Quebec industries have faced more challenges in the U.S. market. The furniture and lumber sectors have been especially hard hit. On top of that, the collapse of the U.S. housing market in the wake of the financial crisis of 2007 and the recession of 2008-2009 also affected many exporting businesses.

Table 1
Main causes of the sluggishness of Quebec’s exports during the 2000s

<table>
<thead>
<tr>
<th>Factors</th>
<th>Consequences</th>
<th>Economic</th>
<th>Structural</th>
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<tbody>
<tr>
<td>U.S. recession of 2001.</td>
<td>End of a long period of growth in exports.</td>
<td>x</td>
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<tr>
<td>Bursting of the technology bubble in 2001.</td>
<td>Decline in the production of telecommunications equipment, the main product exported by Quebec in the early 2000s.</td>
<td>x</td>
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<tr>
<td>Rationalization of the forest sector.</td>
<td>Numerous mill closures reduce production capacity.</td>
<td>x</td>
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<tr>
<td>Textile and garment sector: abolition of import tariffs for many countries in 2002.</td>
<td>Foreign competition intensifies by another notch. Numerous businesses close their doors, a few manage to hold out.</td>
<td></td>
<td>x</td>
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<tr>
<td>More intense competition from Asia, especially China.</td>
<td>Increased penetration by Chinese products in the United States; demand for products from our main international customer weakens.</td>
<td></td>
<td>x</td>
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<tr>
<td>U.S. recession of 2008-2009 and collapse of the housing sector.</td>
<td>Sharp drop in Quebec’s exports. Shipments of lumber and building materials are particularly affected.</td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>Skyrocketing appreciation of the Canadian dollar: from around US65¢ in the early 2000s, to near parity.</td>
<td>Prices of many products are less competitive on the U.S. market, putting a damper on exports.</td>
<td>x</td>
<td>x</td>
</tr>
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</table>

Source: Desjardins, Economic Studies
THE TRADE DEFICIT IS HERE TO STAY

Many exporting industries have been in decline in the past 10-odd years, thereby changing Quebec’s industrial profile. The causes of this weakness are essentially of a structural nature, so it will be difficult to completely catch up to where we used to be. The production capacity of many sectors has been reduced considerably, especially in pulp and paper, lumber (graph 12) and textiles and garments. Even if the global economy firms up next year and demand from south of the border increases, the level of exports will be unable to match the peak of the early 2000s.

More favourable economic conditions will also generate a global recovery in exports in 2014. If the growth in imports levels off somewhat, Quebec’s trade deficit in goods and services could shrink somewhat next year, but it will still be around $30B. Unless the province sets out to conquer the emerging markets, which offer greater growth potential than the industrialized countries, exports will not expand strongly enough to shrink the trade deficit. The trade surplus with the United States should certainly expand once the U.S. economy gains strength, but it is unlikely that this will be enough to outweigh the negative balance with the other trading blocks. The deficit with the other continents will be difficult to reverse, especially that with China, which has increased considerably. Trade agreements between different countries or zones are proliferating, and Quebec is not alone in wanting to expand its economic footprint. Improvement in global economic conditions will mitigate our trade deficit but will not eliminate it. Due to many fundamental changes, Quebec’s trade deficit has expanded in numerous sectors since 2002 (graph 13), such that the total negative balance will not be able to close quickly. The structural factors carry too much weight, so Quebec will have to carry this millstone around its neck for several years yet, and this will limit its potential for economic growth.

The industries that are losing steam will be replaced with other, growing industries that will take centre stage in Quebec’s foreign trade. The aerospace industry, electronic components and pharmaceuticals have made great strides forward in the past decade and are now among the 10 main exporters in Quebec. Our hopes are pinned on the aerospace sector, which is on the verge of taking off with a new line of aircraft that will have repercussions for many suppliers. If the main line of exports from Quebec recovers, the total shipments abroad will do likewise.

Hélène Bégin
Senior Economist