ECONOMIC VIEWPOINT

Are We Starting to See Signs of Reshoring in Canada

By Benoit P. Durocher, Director and Principal Economist

In recent years, heightened geopolitical and trade tensions have challenged the economic models of the past few decades, which have hinged on globalizing trade. Now reshoring is attracting increased interest. With Canada's economy highly dependent on international trade, this could have major consequences for the country. But are Canadian businesses actually reshoring?

After several decades of globalization's ever-increasing impact on international trade, certain developments over the past few years have been challenging this business model. Even before the pandemic, there was a visible uptick in nationalism and trade protectionism. We need look only to the US-spurred renegotiation of the North American Free Trade Agreement (NAFTA), which produced the new Canada-United States-Mexico Agreement (CUSMA) that has been in force since 2020. Some diplomatic and trade relations have also cooled, especially with China, despite it being the focus of many companies' trade strategies for decades. More recently, the war in Ukraine has intensified multiple disagreements on the global economic stage. Several weak spots in the global supply chains also surfaced during the pandemic, which resulted in numerous worldwide shortages and caused inflation to surge.

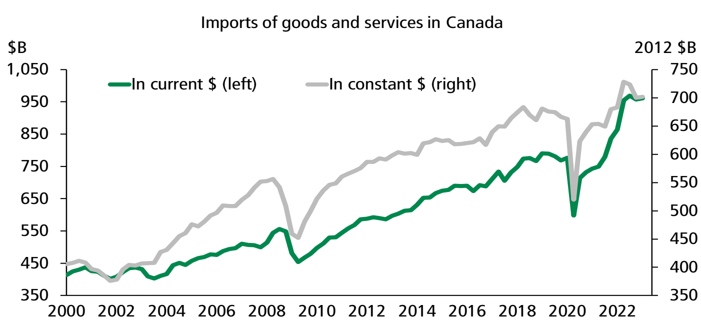
This situation spurred many initiatives to bring some production back home. Reshoring, as it is known, is to some extent a new reality in many parts of the world. Although this strategy can protect businesses from the vagaries of international trade, it brings its own consequences too. Because local wages are generally higher, reshoring often increases production costs. However, with that production now located closer to key markets, shipping costs should move in the opposite direction. There's also an increased argument for reshoring as a component of the fight against climate change. Ultimately, though, reshoring appears to put some upward pressure on producer and consumer prices in exchange for less vulnerability.

The Situation in Canada

Canada may not be immune to this new reality in international trade, but how much is it really affected? Obviously, the situation is quite different from one company to the next, depending on their preferred trade strategies. What we need is a global overview of the reshoring process at Canadian companies.

The initial impulse is to look at the trend in Canadian imports (graph 1). Yet this gives us a rather blurry picture of the situation, which is influenced by many short-term factors such as price increases, economic cycles and, more recently, the pandemic. It's hard to isolate the effect of reshoring among all the data.

GRAPH 1
Imports Continue to Trend Up Despite the Turmoil



Sources: Statistics Canada and Desjardins Economic Studies

To get a clearer view, imports are usually compared to total domestic production. A lower ratio is a sign that a bigger portion of production is done locally rather than abroad. Conversely, a higher ratio signals that global trade accounts for a larger share of production and the economy. As we see in graph 2 on page 2, after gradually increasing until 2008 amid trade globalization, the ratio has been relatively stable for a few years now (excluding the turmoil caused by the Great Recession of 2008-2009 and the recent pandemic). The lack of a genuine downward trend in the ratio suggests that reshoring isn't particularly widespread in Canada for goods or services. However, some will say that if the ratio stabilizes after rising for several years, it probably shows a certain ambition to increase local production.

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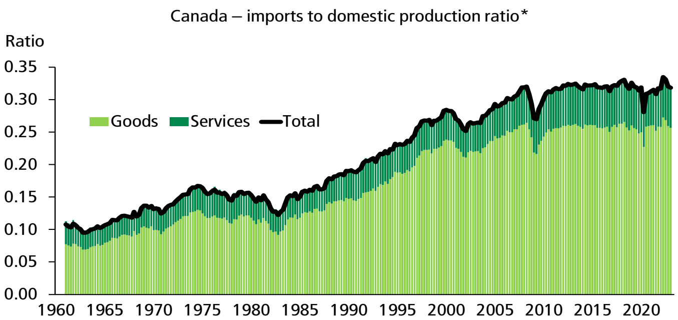
GRAPH 2
Reshoring Doesn't Appear to Be Increasing in Canada



* Real terms
Sources: Statistics Canada and Desjardins Economic Studies

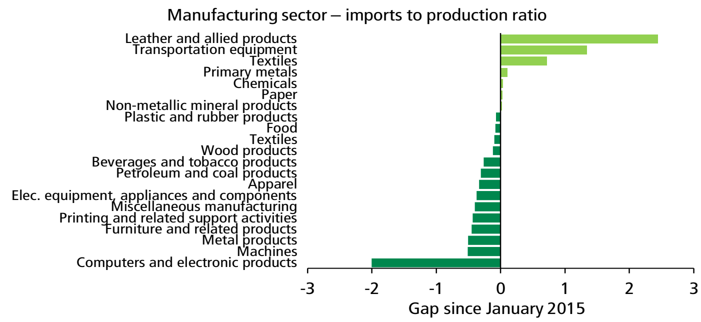
GRAPH 3
Reshoring Seems More Prevalent in Manufacturing

Sources: Statistics Canada and Desjardins Economic Studies

There's more evidence of reshoring if we narrow our focus to manufacturing, where the imports to production ratio has been falling over the past few years (graph 3). Obviously, this aggregate trend masks some quite different realities in the various business sectors. Graph 4 shows the gap in the imports to production ratio for various manufacturing sectors between January 2015 and May 2023. Industries with a positive gap have been more open to imports since 2015, while those with a negative gap are less exposed to imports, a sign of greater reshoring. This is most apparent in computer and electronic product manufacturing, which seems to be undergoing more reshoring, particularly since 2022 (graph 5). This is no surprise considering how scarce chips were during the pandemic, which probably steered many Canadian businesses toward alternative suppliers. To a lesser extent, many other sectors now have a lower exposure to imports, including machinery manufacturing (graph 6), fabricated metal product manufacturing (graph 7 on page 3) and furniture and related product manufacturing (graph 8 on page 3).

Another way to detect reshoring in an industry is by looking at investments. Usually, reshoring some offshore production requires major local investment to build new production capacity. A survey by Statistics Canada shows that a significant portion

GRAPH 4
Some Manufacturing Sectors Seem to Be More Affected by Reshoring



Sources: Statistics Canada and Desjardins Economic Studies

GRAPH 5
Reshoring Seems More Prevalent in Certain Sectors (1)

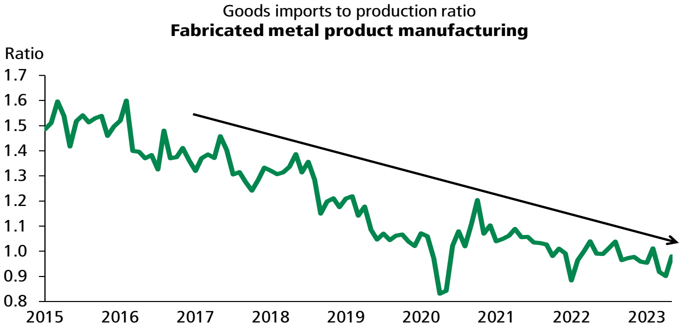
Sources: Statistics Canada and Desjardins Economic Studies

GRAPH 6
Reshoring Seems More Prevalent in Certain Sectors (2)

Sources: Statistics Canada and Desjardins Economic Studies

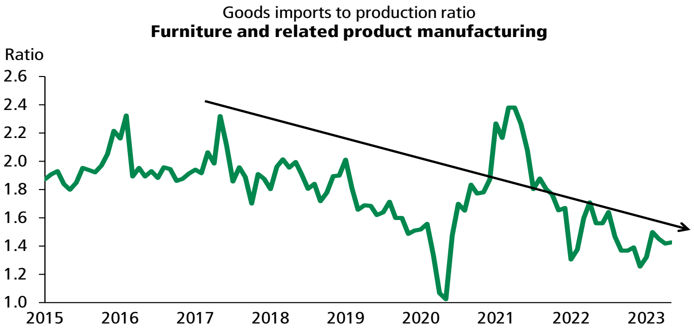
of manufacturing businesses plan to expand their current locations over the next 12 months (graph 9 on page 3). However, a reduction was observed in the third quarter of 2023 within manufacturing, probably due to a cyclical slowdown in global demand in response to the sharp rise in interest rates. The trend in recent quarters nevertheless corroborates the signs of reshoring seen in some manufacturing sectors.

GRAPH 7
Reshoring Seems More Prevalent in Certain Sectors (3)



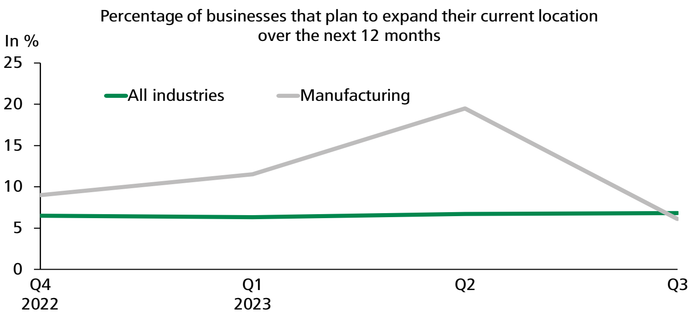
Sources: Statistics Canada and Desjardins Economic Studies

GRAPH 8
Reshoring Seems More Prevalent in Certain Sectors (4)



Sources: Statistics Canada and Desjardins Economic Studies

GRAPH 9
With the Exception of the Last Quarter, Expansion Intentions Are Very High in Manufacturing



Sources: Statistics Canada and Desjardins Economic Studies

Ultimately, although reshoring is more prevalent in certain industries, it appears fairly limited across Canada overall. This may be due to the type of trade Canada engages in. Nearly 62% of goods imports to Canada come from the United States (graph 10), a stable and reliable supply source. This reduces the need to reshore production for many industries, especially since trade ties between Canada and the US are very strong, particularly for motor vehicles. If we include the European Union,

GRAPH 10
Most of Canada's Imports Come from the United States and Other Industrialized Countries

Sources: Statistics Canada and Desjardins Economic Studies

the United Kingdom, Mexico and Japan, all of which have solid trade relations with Canada, the corresponding share of Canadian imports climbs to almost 79%. In short, the need to partially reshore production is probably less urgent in Canada than in other industrialized countries like the US.

Friendshoring—manufacturing or supply chain processes with countries that are geopolitical or trade allies—is becoming increasingly common. A number of factors, including the availability of skilled labour and greater proximity to export markets, can encourage companies to maintain commercial relationships with these countries. However, this trade practice raises some concerns. In addition to higher production costs, it fosters geopolitical divergence while affecting global free trade, which could come at the cost of some economic efficiency. This could make the central banks' goal of stabilizing inflation even more challenging. We'll have to keep a close eye on the situation over the next few years. Right now, it's hard to know whether this is a fleeting period of turmoil or a genuine shift in global trade relations.