

PERSPECTIVE



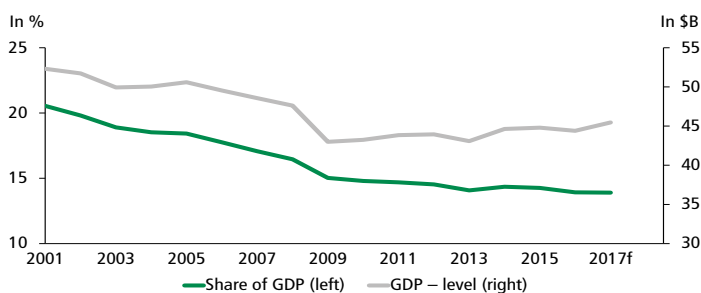
Quebec's Manufacturing Industry Pushes Back

Quebec's manufacturing sector managed to eke out some gains in 2017. The increase in GDP, salaried employment, sales and merchandise exports are proof of this industry's staying power. That said, there's no guarantee that the gains made in 2017 will continue through 2018. Much uncertainty still hovers over the sector: the unpredictable outcome of the North American Free Trade Agreement (NAFTA) renegotiation, mounting countervailing and anti-dumping duties imposed by the United States and the possibility of major tax cuts for U.S. corporations. It would be surprising if 2018 turned out to be the year everything changed, however. With this in mind, the forces at work could reach an equilibrium, especially in terms of North America's economic momentum. As such, Quebec's manufacturing sector could remain relatively stable in 2018. On the other hand, prospecting for new outlets in foreign markets is becoming an increasingly profitable alternative for Quebec's manufacturers.

2017: A Year of Gains

Although 2017 is drawing to a close, statistically speaking, the year always winds up some time later. Nevertheless, based on the GDP data available (January to August 2017), Quebec's manufacturing industry made gains compared to the same period in 2016 (graph 1). A comparison of both periods shows an increase of 2.4%—the best advance since 2014.

GRAPH 1
While manufacturing's GDP climbs in constant \$, its share of total GDP is flat



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

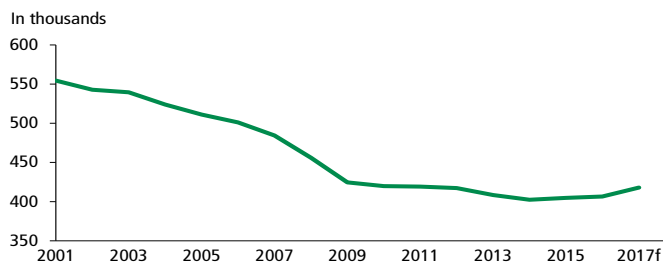
However, despite this progress, the manufacturing industry's share of GDP in the total economy did not expand in 2017. Its relative heft has in fact declined since the start of the century—gradually falling from about 21% in 2000 to around 14% in 2016. The industry won't be able to turn that around by the end of 2017. While it did make some gains, other sectors of the

economy experienced growth, such that manufacturing will maintain the same contribution as in 2016.

Salaried Employment Advances

Despite the scarcity of labour and increased automation on the production line, the manufacturing industry still managed to create jobs in 2017. This goes against the general trend that has become entrenched since the early 2000s (graph 2). Salaried employment experienced a free fall from 2001 to 2008, followed by a more gradual decrease from 2009 to 2014. However, a few gains have appeared since 2015, and this uptrend seems poised to continue in 2017. The year-over-year advance for the first eight months of 2017 is estimated at 2.4%. If this same pace continues

GRAPH 2
Quebec: Salaried employment in manufacturing has regained some ground since 2015



f: Desjardins forecast
Sources: Statistics Canada and Desjardins, Economic Studies

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for the rest of the year, the number of salaried workers should reach 417,000 to 418,000, on average, for the year.

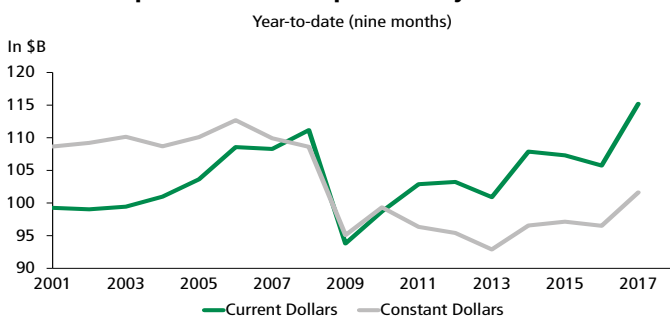
Which sectors are the heavyweights in terms of salaried employment in the manufacturing industry? With 57,502 salaried employees in 2016, or 14.1% of industry workers, food manufacturing tops this list, followed by transportation equipment (aerospace, heavy vehicles, buses, etc.), with just over 42,000 salaried employees or 10.6% of salaried employees, followed closely by metal product manufacturing, with 42,000 jobs. Next in line is equipment manufacturing with about 30,000 jobs, or 7.3% of total jobs, followed by wood products, with about 28,000 jobs, or 6.9% of total jobs, and plastics and rubber products with 27,000 jobs, or 6.6% of total jobs. The top five sectors accounted for 49.2 %—nearly half—of all salaried manufacturing jobs in 2016. This shows the extent to which just a few sectors rely heavily on the workforce.

The manufacturing sectors that created the largest number of salaried jobs between January and September 2017 (in percentage) included chemicals, primary metals, furniture, electrical appliances and components, and food. An interesting aside: the industries with the largest number of employees did not necessarily contribute the most toward boosting the number of hires in 2017.

Manufacturing Sales Also on the Rise

A quick glance at the general trend for manufacturing sales reveals that things have not always been rosy since the year 2000. Graph 3 shows current developments in current and constant dollars (excluding the effects of inflation). These are year-to-date figures for January to September of each year. A quick drop in constant dollars was recorded between 2007 and 2013, which began to recover in 2014. Advances were made in 2017, which is good news. The increase was 8.9% in current dollars and 5.3% in constant dollars for the first nine months of 2017 compared to the same period in 2016.

GRAPH 3
Quebec: Manufacturing sales rose for the first nine months of 2017 compared to the same period last year



Sources: Statistics Canada and Desjardins, Economic Studies

In 2016, the manufacturing industry's heavyweights in terms of the value of sales (in constant dollars) were: food (14.6% of the total), primary metals (13.8%), transportation equipment (12.0%), chemicals (6.9%), paper (6.3%), plastics and rubber (about 6.0%), and metal (5.2%) and wood products (5.2%).

For the first three quarters of 2017, the industries that saw their sales rise the fastest (in constant dollars) were: transportation equipment (+10.1%), computer and electronic products (+9.5%), metals (+8.0%), machinery manufacturing (+7.1%), furniture and related products (+6.2%), and non-metallic mineral products (5.8%). Some sectors suffered declines, with the printing sector posting the worst loss (-5.0%) while others posted scant advances, such as wood products (+1.1%). In all likelihood, manufacturing sales will climb in 2017.

Exports Grow

The industries that have the most heft in terms of the number of employees and sales are those that are most open to doing business outside Canada. Like it or not, the future of the manufacturing industry depends on exports. In a highly exposed sector like machinery manufacturing in the transportation industry, about 80% of the value of manufacturing sales is exported. Openness to international trade is close to 50% for chemicals, more than 40% for wood, a tad less than one-third for food, and about 30% for metals.

This kind of openness leads to trade agreements. In other words, these sectors are subject to the vagaries of negotiations, such as those concerning the renewal of the North American Free Trade Agreement (NAFTA). They are also impacted by negotiators' moods, as we saw recently in the case of Bombardier, which the U.S. slapped with countervailing and anti-dumping duties of 300% last fall. It was also evident in the softwood lumber dispute, which involved these same duties being levied at a rate of around 20% last November.

For the first nine months of 2017, Quebec's exports outside Canada were up 7.7% compared to the same period in 2016. Exports to the United States were up 6.8%. Meanwhile, exports from Quebec to points beyond Canada and the United States rose faster than those headed to the United States. Market diversification seems to be paying off.

What's in Store for 2018?

If we merely consider the fundamentals, such as demand for Quebec products, the situation looks good. It generally reflects North America's strong economy. Quebec and Canada may not be the bright spots in 2018 that they were in 2017, but things look more promising south of the border. While the loonie does not seem poised to soar to a level that could hurt trade, it should hover at around US\$0.80 on average.

Not everything relies on fundamental factors alone, however. Agreement negotiations, the goodwill of trade partners and their attitude toward doing business with Canada—good or bad—are all game-changing elements. We already know that Quebec’s manufacturing industry is facing its share of challenges. In addition to the previously-mentioned countervailing and anti-dumping duties imposed on Bombardier and the softwood lumber industry, the possibility of duties on uncoated Canadian paper (newsprint mostly) in early 2018 is yet another threat. This new issue would have an impact on paper production and the sawmills. Unlike lumber, the paper market has shrunk and the industry’s leeway is pretty slim. In the aerospace industry, we need keep in mind that Quebec has several other successful niches than complete aircraft (engines, flight simulators, parts, etc.); we should perhaps temper our pessimism.

The uncertain outcome of the negotiations to amend NAFTA and the potential tax cuts for U.S. corporations are in addition to the issues discussed here. Regarding the manufacturing sector, it’s worth asking whether the tax cuts will give U.S. plants an edge. Will corporations invest more to meet their own economic needs? Assuming that corporations up their investments, what repercussions will be felt on this side of the border? How fast and impactful will they be? We are dealing with a host of unknowns.

It would be surprising if 2018 turned out to be the year everything changed, however. With this in mind, the forces at work could reach an equilibrium, especially in terms of North America’s economic momentum. As such, Quebec’s manufacturing sector could remain relatively stable in 2018. On the other hand, prospecting for new outlets in foreign markets is becoming an increasingly profitable alternative for Quebec’s manufacturers.

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