

PERSPECTIVE



Quebec and Ontario: A Powerful Economic Force

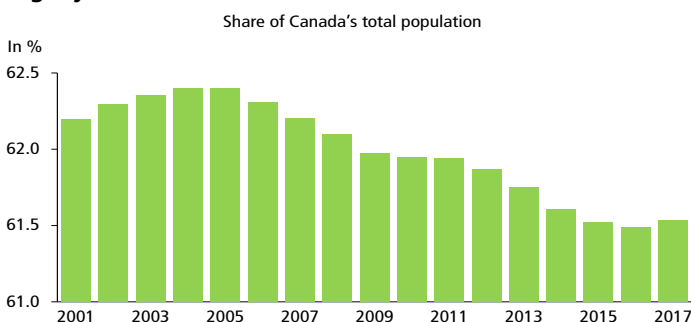
We have a tendency to compare Quebec and Ontario, sometimes even pitting them against each other. We rarely see them as combined economic entity and a powerful force. These two provinces have a combined real GDP of over \$1,000B and account for three quarters of Canada's manufacturing jobs. They are a vital engine driving the country's economy. In addition to being trading partners, Quebec and Ontario are central to Canada's international trade. They are on the frontlines of the battle underway regarding trade with the rest of North America. Let's take a closer look at this little known and often misunderstood partnership.

Strength in Numbers

In terms of demographics, the combined population of Quebec and Ontario was approximately 22.6 million (8.4 million and 14.2 million, respectively) as of July 1, 2017, according to Statistics Canada. This means that the two provinces are home to 61.5% of the country's population. That percentage was even higher if we look back in history. In 1851, it was estimated at 75.6% of Canada's population.¹ By 1901, it had fallen to 71.3% and by 1976, it was 63.1%.

If we look at just the 21st century, the population of both provinces peaked in 2004 and 2005, representing 62.4% of Canadians (graph 1). Since 2006, the relative significance of

GRAPH 1
Quebec and Ontario's share of the Canadian population grew slightly in 2017



Sources: Statistics Canada and Desjardins, Economic Studies

¹ Newfoundland and Labrador, Western Canada the Yukon were excluded from this calculation, *Historical Statistics of Canada*, Statistics Canada, 1983, second edition.

Quebec and Ontario's populations has declined. This is partially due to the oil boom and faster population growth in Alberta and Saskatchewan (Canada's second-largest oil-producing province). At the same time, population growth has also picked up in British Columbia, in part due to Asian immigration. From 2006 to 2017, demographic growth was as follows: 11.3% in Quebec and Ontario (combined), 25.3% in Alberta, 17.3% in Saskatchewan and 13.6% in British Columbia. Nevertheless, Quebec and Ontario still represents just over 60% of Canada's population.

How do these provinces stack up demographically against the rest of the world? Table 1 provides a few points for comparison. The available figures are from 2016, for which the population of Quebec and Ontario was estimated at 22.3 million. This was slightly below Australia's population (24.1 million), but above those of Scandinavian countries combined (20.9 million), Chile (17.9 million) and the Netherlands (17.0 million).

TABLE 1
International population comparison

ENTITY/COUNTRY	POPULATION IN 2016 IN TOTAL NUMBER OF PEOPLE
Quebec (8,321,888) and Ontario (13,976,312)	22,298,200
Australia	24,127,160
Denmark, Norway and Sweden (Scandinavian countries)	20,867,170
Chile	17,909,750
Netherlands	17,018,410

Sources: World Bank and Statistics Canada

François Dupuis, Vice-President and Chief Economist • Joëlle Noreau, Senior Economist

Desjardins, Economic Studies: 418-835-2450 or 1 866-835-8444, ext. 5562450 • desjardins.economics@desjardins.com • desjardins.com/economics

NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

IMPORTANT: This document is based on public information and may under no circumstances be used or construed as a commitment by Desjardins Group. While the information provided has been determined on the basis of data obtained from sources that are deemed to be reliable, Desjardins Group in no way warrants that the information is accurate or complete. The document is provided solely for information purposes and does not constitute an offer or solicitation for purchase or sale. Desjardins Group takes no responsibility for the consequences of any decision whatsoever made on the basis of the data contained herein and does not hereby undertake to provide any advice, notably in the area of investment services. The data on prices or margins are provided for information purposes and may be modified at any time, based on such factors as market conditions. The past performances and projections expressed herein are no guarantee of future performance. The opinions and forecasts contained herein are, unless otherwise indicated, those of the document's authors and do not represent the opinions of any other person or the official position of Desjardins Group. Copyright © 2018, Desjardins Group. All rights reserved.

Where do the provinces stand with regard to the United States? If we compare Quebec and Ontario with the United States for 2017, their combined population was below that of California (39.5 million) and Texas (28.3 million) (table 2). However, it exceeded that of Florida (21.0 million) and New York (19.8 million).

TABLE 2
Population comparison with the United States

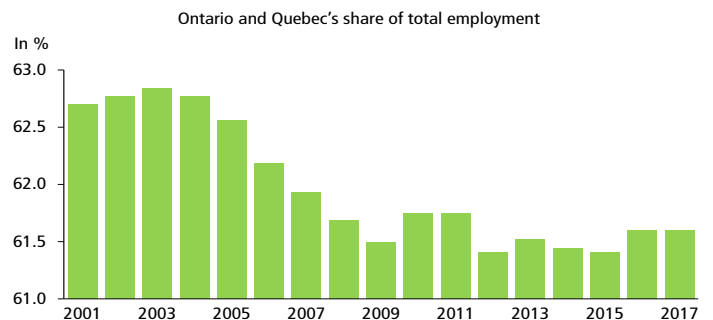
ENTITY/COUNTRY	POPULATION IN 2017 IN TOTAL NUMBER OF PEOPLE
Quebec (8,394,034) and Ontario (14,193,384)	22,587,418
California	39,536,653
Texas	28,304,596
Florida	20,984,400
New York	19,849,399
Plains (Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota and South Dakota)	21,294,107
New England (Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont)	14,810,001
Rocky Mountain region (Colorado, Idaho, Montana, Utah and Wyoming)	12,055,738

Sources: U.S. Census Bureau and Statistics Canada

The two provinces combined still had a greater population than three of the eight U.S. regions. This was the case for the Plains (Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota and South Dakota), which had a population of 21.3 million in 2016. The combined population of Quebec and Ontario also exceeded that of New England (Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont), with a population of 14.8 million, and was almost double that of the Rocky Mountain region (Colorado, Idaho, Montana, Utah and Wyoming), which stood at 12.1 million.

Employment – A Key Parameter

In 2017, Quebec and Ontario made up 61.5% of Canada's population and accounted for 61.6% of its employment (11.4 million jobs) (graph 2). This percentage is the same as for 2016, when a slight uptick in this regard was observed. A breakdown by industry reveals a few concentrated areas: in 2017, 73.1% (1.3 million jobs) of Canadian manufacturing jobs were spread across the two provinces. Finance, insurance and real estate had a greater presence there than elsewhere in Canada (67.8% of Canadian jobs, with 0.8 million workers). Professional, scientific and technical services were more abundant, proportionally speaking, and accounted for 66.1% of this type of employment in Canada (nearly 1 million workers). It is also worth noting that the wages in these sectors are above average.

GRAPH 2
Nearly 62% of employment in Canada is concentrated in Quebec and Ontario


Sources: Statistics Canada and Desjardins, Economic Studies

Let's compare the number of jobs with those in the U.S. regions. In 2016, Quebec and Ontario had a combined total of 11.1 million jobs (4.1 million and 7.0 million, respectively), trailing the Plains, which had 13.9 million jobs (table 3). Presumably, the employment rate was higher in this vast region, which has fewer inhabitants than Quebec and Ontario. However, the two provinces provided more jobs than New England (9.8 million) and the Mountain region (7.6 million). This comparison shows that there is a large, concentrated workforce in Quebec and Ontario.

TABLE 3
Employment comparison with the United States

ENTITY/REGION	EMPLOYMENT IN 2016 IN FIGURES
Quebec (4,133,100) and Ontario (6,999,600)	11,132,700
Plains region (Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota and South Dakota)	13,924,355
New England (Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont)	9,795,354
Rocky Mountain region (Colorado, Idaho, Montana, Utah and Wyoming)	7,622,064

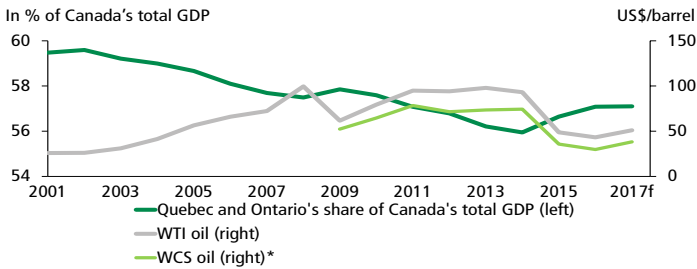
Sources: U.S. Census Bureau, Bureau of Labor Statistics and Statistics Canada

Share of GDP, a source of competition with the other provinces

The most comprehensive provincial data is for 2016 and shows that the combined GDP of Quebec and Ontario was just over \$1,000B (\$343.3B and \$685.0B, respectively), representing 57.1% of Canadian GDP for the year. Since the start of the century, Quebec and Ontario's share has hovered between 55.9% and 59.6%, thanks to a relatively favourable economic situation.

Graph 3 on page 3 shows the gradual decrease in Quebec and Ontario's percentage of GDP as oil prices have gone up, suggesting that the oil-producing provinces have increased their

GRAPH 3
Ontario and Quebec's GDP has risen as energy prices have plummeted



f: Desjardins forecasts; WTI: West Texas Intermediate; WCS: Western Canadian Select;
 * 2009 is the first full year for data.
 Sources: Datastream, Statistics Canada and Desjardins, Economic Studies

contribution to Canada's economic performance to the detriment of Quebec and Ontario. Conversely, the drop in fossil fuel prices in 2014 marked the start of the recovery of Quebec and Ontario's share of Canada's total GDP. Nevertheless, this economic area accounts for more than half of the country's GDP.

How should we assess these two provinces' share while taking into account the spike in oil prices in 2017 and positive outlook for 2018? We should not count on a surge in crude oil prices in the next few years, which could spur oil operations in Western Canada. However, Quebec and Ontario can expect to maintain a significant contribution to the GDP of approximately 57% until 2020. On the other hand, if trade relations with the United States deteriorate, it would lead to a significant drop in the two provinces' percentage of the Canadian GDP.

The Importance of Housing Starts

Quebec and Ontario accounted for 57.1% of housing starts in Canada in 2017 (21.1% and 36.0%, respectively), down slightly from 2016 (57.5%). Since the start of the new millennium, this percentage has wavered between 51.1% (in 2007) and 63.4% (in 2000). What has caused this fluctuation? Activity in Western Canada is likely the culprit. The drop in 2007 corresponds to a period of intense activity in Alberta (oil sands operations) and British Columbia (strong trade with Asia, particularly China), when these two provinces accounted for 21.2% and 17.2% of Canadian housing starts, respectively. Just a few years earlier, their percentages were lower.

A second dip occurred in 2014, when energy prices soared and then plummeted in the second half of the year. At the time, Alberta's housing market was booming, leaving less room for Quebec and Ontario. Why haven't these two provinces been able to fully recover and return to the 60% range for housing starts in Canada that prevailed before oil prices took off? The answer lies in British Columbia's strong economic growth, which outpaced that of Quebec, Ontario and the Canadian average from 2014 to 2017. The province's housing market has been extremely tight for decades and has reached a fever pitch. This is primarily due

to its robust economy, as well as sustained demographic growth, which have pushed up prices in the residential sector and new construction. As a result, Quebec and Ontario's share of new construction has remained below 60% despite accounting for a slightly higher percentage of Canada's population.

Quebec and Ontario's Strengths

Manufacturing is one area in which the two provinces excel and are a major force. In 2016, they represented 72.0% of Canadian manufacturing sales. Estimates for 2017 are at 70.6% (\$155.5 billion and \$302.5 billion). The automobile and aeronautics sectors, which are concentrated in Ontario and Quebec, respectively, play a key role in the Canadian economy.

However, their exports have fluctuated in the last 10 years. In 2016, the value of Quebec and Ontario's international exports was approximately \$330 billion and accounted for almost 64.0% of Canadian exports (\$80.4 billion and \$249.5 billion, respectively) (graph 4). Overall, Ontario's international exports are nearly three times higher than those of Quebec. For 2017, we observed a slight decrease at \$325.7 billion (59.6% in percentage). This result is based on a dip in the value of Ontario's exports (primarily in the automobile industry). At the same time, we saw an increase of 26.4% last year in Alberta and 12.5% in British Columbia, reducing Quebec and Ontario's contribution to Canada's total.

GRAPH 4
Quebec and Ontario's share of Canada's total international exports has fluctuated for 10 years

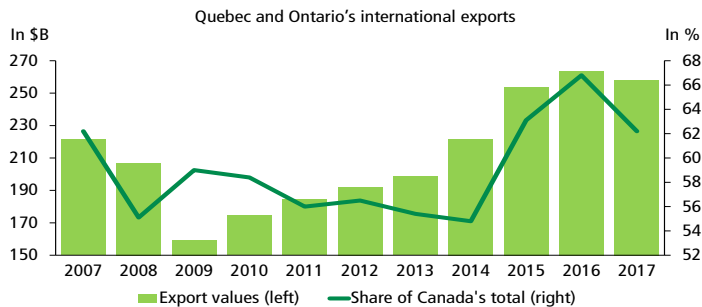


f: Desjardins forecasts
 Sources: Statistics Canada, U.S. Census Bureau and Desjardins, Economic Studies

Quebec and Ontario's share remained below 60% from 2008 to 2014, a period in which energy prices were relatively high and caused shipments by the provinces extracting hydrocarbons to swell. This led to declines for the non-oil and gas provinces. In addition, at the start of the 2008–2009 recession, the automobile sector took quite a hit, which slowed down trade between Ontario and the United States considerably.

Quebec and Ontario's share of trade with the United States is slightly higher than its share of international trade (graph 5 on page 4). In 2016, it stood at 66.8%. However, in 2017, it was 62.2% (14.5% and 47.7%, respectively). The rise in energy prices

GRAPH 5
Quebec and Ontario's exports to the United States
fell in 2017



f: Desjardins forecasts
 Sources: Statistics Canada, U.S. Census Bureau and Desjardins, Economic Studies

enabled Alberta to recover some of the ground it had lost in recent years.

When it comes to the North American Free Trade Agreement (NAFTA) renegotiation, it is clear that Quebec and Ontario are directly affected. Of the two provinces, Ontario is the most vulnerable due to its extensive economic integration with the United States and how intertwined it is with North American production chains. Some 82% of Ontario's international exports head to the United States, compared with approximately 71% for Quebec. However, Quebec has certain sectors that are more at risk. These include aluminium, as well as the agricultural sector, which has been in the United States' sights for a long time. These are in addition to the battles underway in the softwood lumber and paper industries, which have been making headlines.

However, Quebec and Ontario are less vulnerable now than they were in the early 2000s, when the manufacturing sector accounted for a larger percentage of their combined economy. At the time, its share was close to 20%, whereas today, it is approximately 14% in Quebec and 12% in Ontario.

Quebec and Ontario: A Long-Standing Relationship

For many years, Quebec and Ontario have strived to facilitate trade and improve the economic and cultural relationships between the provinces. An example of this is the interconnection agreement between Hydro-Québec and Ontario Hydro signed in the late 1970s. Another is the Agreement for Cooperation Between the Gouvernement du Québec and the Government of Ontario Regarding Culture (2006).

In recent years, the two provinces have strengthened their economic ties. A key milestone was the signing of the Ontario-Quebec Trade and Cooperation Agreement (OQTCA), which took effect in 2009. The agreement focuses on two main components: economic, regulatory and energy cooperation and trade liberalization. Many aspects are covered, including labour mobility, the environment and sustainable development, and

public procurement. An update regarding public procurement came into effect in January 2016.

Clearly, the relationship between Quebec and Ontario goes back a long time. This analysis shows that the two provinces play a central role in Canada's economy and, together, they are a powerful force. They are on the frontlines of the battle underway regarding international trade with the rest of North America. How will they fare, both individually and jointly, in this tough fight? Will the circumstances allow them to redefine their relationship? Is this an opportunity to rediscover an underestimated internal market?

Joëlle Noreau, Senior Economist