ECONOMIC VIEWPOINT

Quebec's Trade with the European Union

For exports, geographic diversification should intensify

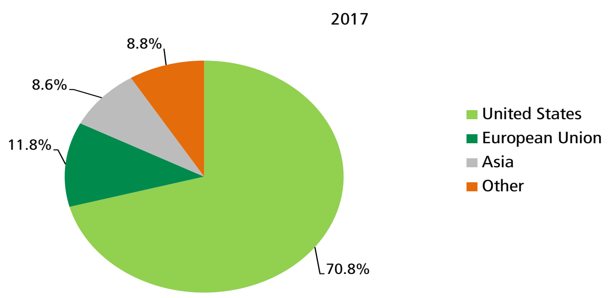
With protectionism on the rise around the world, especially in the United States, and the North American Free Trade Agreement (NAFTA) renegotiations dragging on, the issue of more diverse export markets for Quebec is resurfacing. Merchandise shipments to trade blocs like Europe and Asia have gained ground in the last few years, while the share going to the U.S. has declined. This trend should accelerate in the coming years as businesses jump on new opportunities overseas. Canada's recent trade agreements, for example the agreement with the European Union (EU) and the one with several Pacific rim countries, expand the opportunities for Quebec's international exports.

Picture of Quebec's International Trade

While the United States remains the leading foreign outlet for Quebec's exports, the EU and Asia have increased their shares over the years, together accounting for about 20% of the province's international shipments (graph 1). In 2017, the value of products exported to EU countries was in the neighbourhood of $10B, an increase of about 10% over 10 years. What remains to be seen is whether growth will strengthen as a result of the coming into effect of Comprehensive Economic and Trade Agreement (CETA) between Canada and EU on September 21st, 2017.

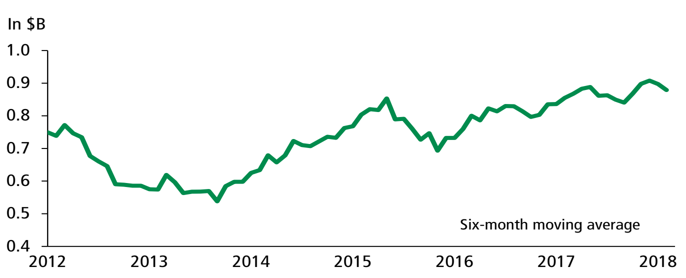
It is still too soon to assess the agreement's impact on Quebec exports, as statistics for the geographic zones vary substantially from month to month, for a variety of reasons. In addition to the economic situation's effect on demand, the type of products exported in some periods of the year in particular can sometimes trigger major monthly fluctuations. The recent trend is not indicating a clear direction that would allow us to reach any conclusions on Europe (graph 2). In any case, the CETA's benefits could take several years to really be felt, as happened when the Free Trade Agreement with the United States (FTA) came into effect at the end of the 1980s (box on page 2).

GRAPH 1
Proportion of Quebec's international goods exports by destination



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

GRAPH 2
Quebec's exports to Europe are not showing a clear direction



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

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Quebec's Trade with the EU

The products Quebec exports to the EU[1] primarily head toward France, Germany and the United Kingdom[2] (table 1). This is not necessarily where the exports end up, but it is where the merchandise enters European territory. About 10% of shipments go to the Netherlands, transiting through Rotterdam, a major port; 10% go to Spain, mainly through the port of Barcelona.

TABLE 1
Quebec's goods exports to EU

COUNTRY	2017	
	$B	%
1. France	1.7	16.9
2. Germany	1.3	13.2
3. United Kingdom*	1.3	12.8
4. Netherlands	1.0	10.0
5. Spain	1.0	10.0
6. Other member nations	3.7	37.1
Total EU	**10.0**	**100.0**

* The United Kingdom remains a member of the European Union for now.
Sources: Institut de la statistique du Québec and Desjardins, Economic Studies

These five countries are the initial landing point for about two thirds of Quebec's exports to the EU; the remaining is distributed among the other 23 member nations. In terms of product groups, aerospace represents the largest value, followed by ore and machinery and appliances for nuclear reactors (table 2).

TABLE 2
Principal products of Quebec exports to EU

PRODUCT GROUPS	2017	
	$B	%
1. Aerospace	2.5	25.4
2. Ore	1.9	18.5
3. Machinery and appliances for nuclear reactors	1.8	18.0
4. Medical, optical and measuring equipment	0.5	5.1
5. Fuels	0.5	4.7
6. Other products	2.8	28.3
Total of all products	**10.0**	**100.0**

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

The EU: Quebec's Second Biggest Supplier

Although products from Asia flooded many merchants' shelves in the 2000s, the United States remains the main source for the province's imports (graph 4 on page 3). The EU ranks second, with imported goods valued at $22.6B, and Asia is close behind. The main products Quebec imports from Europe are motor vehicles, petroleum products, and parts for aerospace production.

[1] European Union member nations: Austria, Belgium, Bulgaria, Cyprus, Croatia, Czechoslovakia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom.

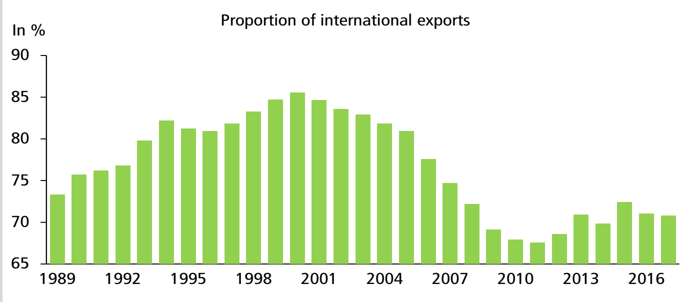
[2] The United Kingdom remains a full member of the European Union for now.

BOX

The U.S. Market's Weight Has Declined

Although the United States still leads in terms of Quebec's international shipments, the market has lost ground from its peak in the early 2000s. At that time, over 85% of the province's exports abroad went to the U.S. The FTA signed with the United States in 1989, and NAFTA, which replaced it in 1994 and brought in Mexico, initially boosted Quebec's trade with the country next door. The proportion of goods shipped to the U.S. market, which was below 75% before the first agreement came into affect, increased gradually and peaked 10 years later (graph 3).

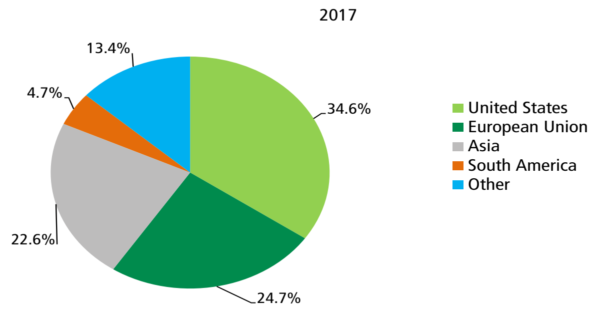
GRAPH 3
Share of Quebec's shipments to the United States



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

After that, a number of structural and situational factors helped decrease exports to the U.S. First, the U.S. recession of 2001, which coincided with the bursting of the tech bubble, dealt a severe blow to our exports, particularly telecommunications equipment. Then came the rationalization of the forestry sector, as well as the textile and apparel industries, which reduced exports to the United States. Heavier competition from Asia in the U.S. market and the loonie's rise (it was around US$0.65 at the start of the 2000s) also reduced Quebec's exports. After that, the U.S. recession of 2008–2009 and the collapse of the housing sector further decreased demand for our products. At that time, the share even fell below 70%, and has not increased much since then. The United States does not have nearly the weight it used to have in Quebec's international trade. Exports to Europe and Asia have gained ground, decreasing the risk of having our economy overly dependent on a single trading partner.

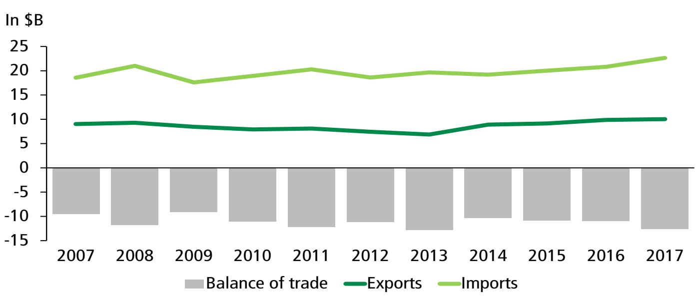
GRAPH 4
Proportion of Quebec's international goods imports by origin



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

The value of Quebec's imports from the EU is currently twice as high as that of its exports to the EU, with the result that there is a trade deficit of more than $10B between the two economies. As several of Quebec's industries import parts for production from Europe and the final product is frequently exported after that, the trade deficit is not necessarily revealing (graph 5).

GRAPH 5
Quebec's trade with the EU



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

Some sectors, such as aerospace, are highly integrated, with many parts transiting between plants on both sides of the Atlantic. Because Quebec buys a lot of petroleum products and motor vehicles from Europe, this trade deficit is not really a concern. The CETA signed last fall will no doubt stimulate both exports and imports, so the agreement's impact on the trade balance is hard to assess. In any case, the primary goal is to create new business opportunities for both partners, and facilitate the trade in goods and services across the board.

As soon as the CETA[3] came into effect, nearly all duties on the trade in goods were eliminated, opening doors for each partner. Countries like the United States that do not have this kind of agreement are running into the problem of keeping prices competitive while paying tariffs in some sectors. Seafood is an example that speaks volumes: Europe now favours Canadian and Quebec products, rather than U.S. products, due to the cost difference associated with the tariffs levied on the U.S. U.S. protectionism and lack of openness to the free market hurt industries that are competing with countries that have multilateral trade agreements.

Europe and Asia Will Gain Ground

While Canada has been tightening trade ties with numerous parts of the world, the U.S. is tending to isolate itself. The United States did not sign the CETA, and also withdrew from the Trans-Pacific Partnership[4] right after the presidential election in 2016. This kind of trade isolation on the part of the United States contrasts with the global trend toward building alliances in order to facilitate trade.

At the same time, Canadian and Quebec businesses are getting a comparative edge on costs due to the gradual removal of trade barriers. This makes the markets in the EU and the trans-Pacific zone's 11 member nations more accessible. Growth by Quebec's exports to these trade blocs should therefore intensify in the years to come. While the United States maintains the advantage of proximity, its importance in our trade should continue to decline. The ongoing NAFTA negotiations, which seem poised to drag on indefinitely, represent one more uncertainty for Quebec's exports to the U.S.

Moreover, the United Kingdom's exit from the EU, which should officially occur on March 29, 2019, could complicate trade. This country is the third biggest destination for Quebec exports to Europe and it is particularly important for the aerospace sector. A post-Brexit transition period[5], whose length and terms have yet to be established, postpones the potential impact on Quebec's international trade sector, however.

Exports to Europe and Asia will keep gaining ground, lessening the risk of overly-great economic dependence on a single trading partner. However, more will have to be done to promote Quebec products in overseas markets and adapt distribution networks accordingly, which takes time and investment. The ability of businesses to increase their presence overseas will also be dependent on their ability to recruit enough labour. Some companies are already struggling to meet demand and are being forced to turn down additional orders because of a labour shortage. Some may even opt to reduce exports to the U.S. market in order to capitalize on new opportunities

[3] Canada–European Union Comprehensive Economic and Trade Agreement: An overview of the agreement, trade and advantages, Desjardins, Economic Studies, *Economic Viewpoint*, April 22, 2015, 20 p.

[4] The New Trans-Pacific Partnership: Smaller, but Just as Ambitious, Desjardins, Economic Studies, *Economic Viewpoint*, March 16, 2018, 4 p.

[5] Brexit: One Year to the Divorce, Desjardins, Economic Studies, *Economic News*, March 28, 2018, 1 p.

with the countries that signed the recent trade agreements. In short, it is much to soon to evaluate the impacts of the coming into force of the CETA on September 21st, 2017. However, Quebec's international exports have already started to diversify geographically, and this should continue.

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