



# Environmental Scan

## Quebec

2018-2020 HORIZON

September 2018 Update



The *Labour Market Analysis Directorate* – Service Canada, Quebec region, looks back at the factors that influenced the setting of its 2018-2020 economic scenario in the first quarter of 2018, and where they have taken us so far

**In early 2018** the situation was as follows:

The situation **in September 2018**:

### ECONOMIC CONTEXT

Economic growth will continue in 2018 and 2019, but the momentum will be lower, as the uncertainty over the protectionist discourse of the United States is harming private investments

Healthy economic climate, the momentum is lower, as expected, but higher than what was seen between 2012 and 2016

→ U.S. protectionism is harming private investments in Quebec

### HOUSEHOLD CONSUMPTION

Stimulating environment: rising disposable incomes, low inflation and low interest rates—small rate increases are expected over the year but will not curb consumption

Inflation will rise due to Canadian tariffs on American products and the ongoing growth of interest rates

→ GDP growth could slow by 1 to 2 tenths of a point

### FOREIGN TRADE

American tariffs are lowering the potential growth of exports, the renegotiation of NAFTA has not been concluded, some industries are targeted by the U.S. Commerce Department

U.S. measures are causing less harm than expected

→ however, the Canadian response to U.S. tariffs is leading to an increase in inflation and affecting local businesses

### LABOUR

Replacement indices are deteriorating in Resource-oriented and Manufacturing Regions, recruitment difficulties will get worse, i.e. replacing retirees will be more challenging, and business growth will be difficult to achieve

Labour market indicators are excellent, and those for 20-64 year-olds, the core of the workforce, are still improving a bit further

→ however, this cannot be relied upon to ensure business growth or effective workforce management

## ECONOMIC CONTEXT

**Forecasts from major banking institutions in Canada**  
Changes in the forecast since October 2017

GDP	2018	2019	Employment	2018	2019	Unemployment	2018	2019
	2.2% (0.2)	1.7% (0.2)		1.2% (0.1)	0.7% (0.1)		5.4% (0.4)	5.3% (0.4)
	2.0% (0.2)	1.8% (0.1)		1.2% (0.1)	0.9% (0.1)		5.8% (0.4)	5.7% (0.5)
	2.9% (0.6)	2.4% (0.4)		1.6% (0.3)	1.3% (0.3)		3.9% (0.4)	3.6% (0.6)

( ) outlook improvement and number of percentage points

( ) outlook decline and number of percentage points

Source: Outlooks consolidated on August 27, 2018 by the Labour Market Analysis Directorate, Service Canada – Quebec region.

Although the renegotiation of the *North American Free Trade Agreement* (NAFTA) was a priority in spring 2017, the issue has not yet been settled. Canada and the United States are both focusing on aspects which upset the other party. For example, Canada is seeking to preserve the dispute settlement mechanism, which the United States is trying to abolish; conversely, the U.S. team wants a sunset clause. The latter would lead to a review of the Agreement every five years, which Canada is rejecting, as it would entrench uncertainty within NAFTA. In fact, it would be impossible for a business to invest, not knowing whether the Agreement would still be there in five years, or if conditions would be the same. Canada and the United States are in disagreement in regards to other spheres such as supply management, access to public and financial markets, protection of cultural differences and the use of electronic data.

The agreement in principle between the United States and Mexico on August 27 is adding pressure because fundamental demands from Canada, mainly relating to the independent dispute settlement mechanism, were retracted. The United States has invited Canada to join this agreement and has requested access to the markets subjected to supply management. As the American President has already told Congress that he would seek to obtain its approval for the official recognition of the agreement in principle with Mexico (within 90 days), Canada has until the end of September to reach an agreement with what now appears to be two bilateral agreements, rather than a tripartite agreement. Then, the text of the agreement must be submitted to Congress for review. The U.S. President has added that in the absence of significant gains in Canadian markets and the withdrawal of some demands from Canada, further tariffs will be imposed.

Currently, American tariffs are affecting the following Canadian products sold to the United States: metals and articles of aluminum or steel, softwood lumber, PET resins, solar panels and pipes for pipelines. Canada won its case before the *World Trade Organization* (WTO) in regards to the tariffs that have been imposed since 2015 on supercalendered paper, but the United States has appealed this decision. Newsprint and white printing paper were taxed in August 2017, but the U.S. trade commission investigation gave its verdict a year later: Canadian imports were not hurting the local industry. The same situation affected large, 100 to 150-seat aircraft in 2017, before the commission stated, in February 2018, that this was not a matter for legislation.

There is concern that the next industry potentially affected by U.S. tariffs may be motor vehicles and parts manufacturing. The Department of Commerce launched an investigation under Section 232 to determine whether imports from Canada, Mexico and elsewhere threaten to impair the national security, i.e. the national production capacity, of the United States. Uranium (ore and products) is also being investigated from a national security perspective, which presents an additional risk for Saskatchewan's and Ontario's economy, as Canada provides one third of American uranium imports.

Although the U.S. law comprising Section 232 went into effect in 1962, it was first invoked in 1981, and would be used seven times over 36 years, from 1981 to 2017. Since the current administration took office, four investigations on the grounds of national security have been launched (aluminum, steel, uranium, motor vehicles) in addition to anti-dumping and countervailing duties on a range of products. These measures allow the United States to apply tariffs on imports rapidly, and can be only opposed through a legal process that generally lasts three to five years.

Some countries affected by U.S. tariff measures have chosen to do the same and apply tariffs to imports on selected American products. The United States announced that they would reply accordingly. This has led to an unprecedented duel with China. While over the past few years, Canada has spoken of the many opportunities offered by trade agreements, including those with the European Union and partners in the Pacific Rim, now we are faced with an international dispute.

Due to the current climate, the WTO expects the growth of international trade to be lower than previously expected, especially in the second half of 2018. Already orders have fallen and international transportation indicators point to a decline of goods transportation.

They are not the only ones to worry. The *Federal Reserve Bank* pointed out that the escalation of trade tensions can potentially penalize the U.S. economy, despite the strong growth it is currently seeing. U.S. manufacturers are already reporting that the new measures have led to price increases and to supply difficulties in all districts, besides increasing market uncertainty. For its part, Canada fears that third countries are trying to dump here their products that were not sold to the United States due to tariffs, which would harm the Canadian industry even further.

Until now, Canadian producers have been rather spared. Businesses are saying that, in most cases, tariffs are billed to clients, except in the steel industry, where it was reported that contracts had been lost or renegotiated to share the extra costs. According to the business environment, uncertainty has increased because the economic environment could change at any given moment. However, as the second half of the year is under way, major Canadian financial institutions have raised their forecasts for 2018 and 2019. Only the Canadian GDP growth forecast was moved to 2019. For the rest, all indicators are more positive than in the beginning of the year.

However the threat is real and for some time we have seen the impact on private investments, or rather in the lack of private investments. Uncertainty is leading to the postponement of investments, both in Quebec and in Canada. This is worrying many, as this growth potential is lost. This being said, the investors' point of view is very much understandable: it is not possible to expand production capacity while the future is unclear. In some instances, businesses have chosen to invest in the United States instead of Canada to bypass current or potential regulations. For instance, Bombardier went that route for the assembly of the C Series (renamed the A-220), which will take place at the Airbus plant in Mobile, Alabama, in regards to contracts with American businesses. Others chose to go this way a few years ago to avoid the *Buy American Act* regulation and the multiplication of tariff and non-tariff barriers in the United States since 2015.

## Consumption

Household consumption, which accounts for two thirds of Quebec's GDP, is doing well. The province saw a strong growth in retail sales during 2016-2017. Such a momentum had not been seen in over a decade. Consumption growth will continue, but at a slower pace, as incomes are rising slowly, even in a context of high labour requirements, as reaction to labour market pressures can take several years, because of collective agreements and investment in production automation.

Higher interest rates could also play a role. The Bank of Canada indicated early in the year that it would proceed with adjustments during 2018. The Bank has already raised the key interest rate by one quarter point, just as it did in 2017, and another quarter point increase is expected for next October. Borrowing will thus be more expensive.

Inflation jumped significantly recently. According to the Bank of Canada, the CPI reacted to pressures created by the rising prices of fuel and of services affected by recent minimum wage increases. However, pressure will also increase as Canadian tariffs—the response to U.S. tariffs on steel and aluminum—will have an impact on the prices of U.S. imports, including consumer products as well as industrial products used in the manufacturing sector. All this could decrease economic and employment growth even further, besides adding pressure on households, where debt management is tight.

## EMPLOYMENT OUTLOOK IN QUEBEC – 2018-2020 HORIZON

The LMAD remains vigilant in regards to NAFTA and U.S. measures. This being said, the scenario for Quebec remains unchanged and the likelihood of taking place is extremely high for 2018. Employment growth could even slightly exceed forecasts.

For 2019 and subsequent years, it could all come into review, mainly if the United States targets the automobile industry. The impact would be huge on the Ontario economy and in turn, those of Canada and Quebec. Secondary impacts would affect industries that are strongly linked to this production, including steel and aluminum production, and plastic and rubber product manufacturing.

If the NAFTA renegotiation is not successful and leads to the U.S. leaving the treaty, scenario dynamics will be adjusted to take into account business community concerns even if, in the short term, the legal environment would remain unchanged due to the delays in implementing such a decision.

**LMAD Scenario – Employment Growth by Activity Sector**

Province of Quebec	2018	2019	2020
<b>All industries</b>	<b>1.0%</b>	<b>0.9%</b>	<b>0.8%</b>
Goods-producing sector	0.4%	0.5%	0.5%
Services sector	1.1%	1.0%	0.9%

**Note:** In preparing this document the authors took care to base their research on labour market information that was accurate and relevant at the time of publication. Since labour market conditions are dynamic, some of the information presented here may have changed since this document was published. Users are encouraged to also refer to other sources for additional information on the local economy and labour market. Information contained in this document does not necessarily reflect official policies of Employment and Social Development Canada.

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