SPECIAL REPORT

TD Economics

February 8, 2016

CANADA-U.S. CROSS-BORDER SPENDING: A REVERSAL OF FORTUNES

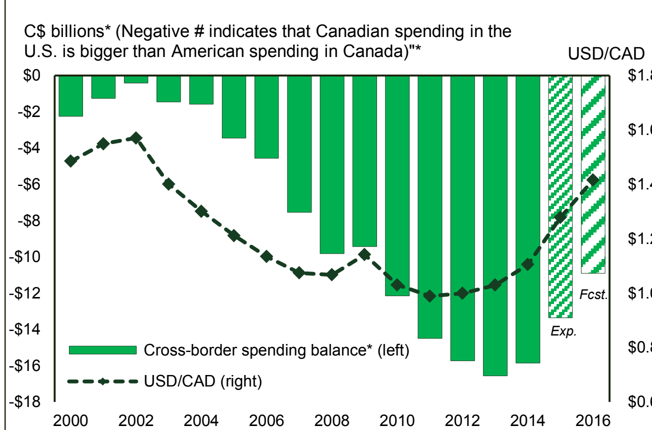
Highlights

- Since 2002, cross-border flows of travel and spending have been heavily tilted toward the south. But a plunge in Canadian dollar is turning the tables by curtailing Canadian visits to the U.S. and stimulating more American visits to Canada. With the loonie expected to average roughly 71 US cents this year – about 7 cents lower than 2015 – these trends will almost certainly intensify in 2016.
- Canadian visits to the U.S. are expected to fall to the lowest levels since the Great Recession this year, with daily visits likely to see another sharp decline at roughly double the rate of overnight visits. As a result, Canadian spending in the U.S. is expected to shrink to around C$20.5 billion in 2016.
- With much of the spotlight on shifts in Canadian travel, considerably less is known about U.S. travel behavior in Canada. A comparison of the data highlights some notable distinctions.
- American visits to Canada are finally picking up. Total visits were up 1.6 million in the first 11 months of 2015 compared to the same period in the prior year. With a similar momentum likely to carry over in 2016, American spending in Canada is poised to rise to C$9.6 billion – the highest level in over a decade.
- This gain in American spending, combined with a decline in Canadian spending stateside, is projected to narrow the cross-border spending gap to around C$11 billion. That said, Canadian visits south will continue to overshadow American visits north, and Canadians are expected to spend in the U.S. at least double the aggregate amount that Americans will spend in Canada.
- The Canadian economy will not reap all the benefits of this swing in fortunes, as some of the spending that would have occurred in the U.S. will be saved or spent in other parts of the world. Nevertheless, a simple calculation pegs the cumulative direct economic boost to Canada at C$4-5 billion over the 2015-16 period.

Since the early 2000s, cross-border flows of spending between Canada and the U.S. have swung dramatically in the southerly direction. In 2002, Canadians spent about the same amount in aggregate as Americans spent north of the border (see Chart 1). By 2013, a whopping gap of nearly C$17 billion was recorded, owing to a combination of strong growth in short and longer haul stays by Canadians stateside and a dramatic decline in U.S. visits to Canada. Put another way, total American outlays in Canadian malls, hotels and restaurants amounted to only 30 cents of each dollar spent by Canadians in the United States.

Since 2013, however, the tables have started to turn. A plunge in the value of the Canadian dollar has shifted the economics of Canada-U.S. travel and purchasing power significantly. Facing a 35-40% higher price tag based on

CHART 1: CROSS-BORDER SPENDING GAP TO NARROW WITH LOWER LOONIE



Source: Statistics Canada. *Spending less fares. "*Data prior to 2013 pertains to an older methodology, re-indexed by TD Economics for illustrative purposes.

Derek Burleton, VP & Deputy Chief Economist 416-982-2514
Admir Kolaj, Economic Analyst 416-944-6318

simple currency adjustment alone has led to a considerable pullback in the number of Canadians heading south, especially on a short-term basis. Meanwhile, Americans have put their strengthening pocketbooks and super-charged greenbacks to use by increasing travel to Canada. With the slide in the loonie likely to continue this year, we expect that the cross-border spending deficit will narrow for a third straight year in 2016 – to about C$11 billion.

This reversal in cross-border spending flows will deliver benefits to the Canadian economy. In addition to the lift provided by increased U.S. traffic, a significant share of the money that would have been spent by Canadians in U.S. destinations is no doubt being redeployed in Canada. A back of the envelope calculation puts this direct economic benefit on the order of C$4-5 billion – or about $2-2.5 billion per year – over the 2015-16 period.

These largely currency-related impacts are not small, but nor do they imply a fundamental change in cross-border spending activity. Canadian longer-term stays in the U.S. – which includes snowbird activity and where much of the total spending is concentrated – have proven resilient to currency swings. Many Canadians will be inclined to keep a hold of their existing U.S. properties, some will rent and a few will still opt to purchase real estate in prime U.S. markets for lifestyle reasons or to profit on expectations of further home price appreciation. Furthermore, recent surveys have suggested that Canadian tourism destinations still face challenges attracting Americans, particularly among the younger cohorts.

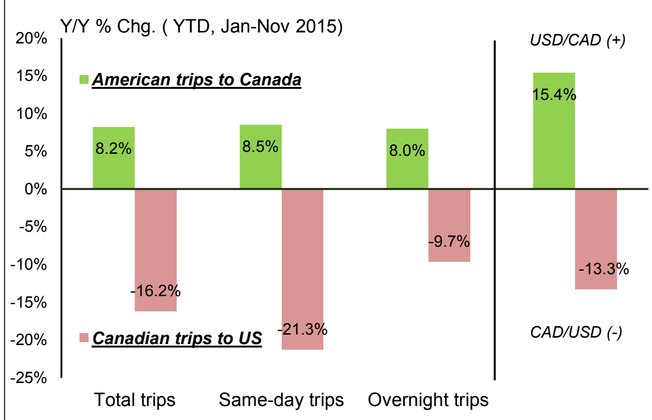
Fewer Canadians heading stateside, spending falling

While increased commercial airline routes have resulted in some international diversification of travel, trips to the U.S. still account for an impressive 80% of the total taken by Canadians. As Chart 2 shows, the ongoing dominance of U.S. travel conceals a major longer-term shift in the nature of travel away from same-day trips to overnight stays. The sharp Canadian dollar depreciation in the 1990s got the ball rolling since the prompt, largely shopping-oriented, excursions have historically been highly currency-sensitive. But even as the loonie rebounded strongly over the 2003-13 period, the number of same-day visits remained about half of the previous peak. This growing preference for overnight stays has reflected a number of factors, including the advancement of e-commerce and beefed up border security since 9/11 – both of which have lessened the advantage and convenience of short stays. Demographics have also been at play, since a growing number of aging baby boomers have been seeking longer visits in warmer climates.

The most notable impact of the rising share of longer-duration stays has been on spending. Canadians earmark an average of roughly C$900 for an overnight trip to the United States, about ten times the average spent on a same day voyage (roughly C$85, for more detail see Chart 11). Accordingly, aggregate outlays by Canadians in the U.S. market have virtually doubled since the early 2000s – reaching a record of C$23.8 billion in 2013.

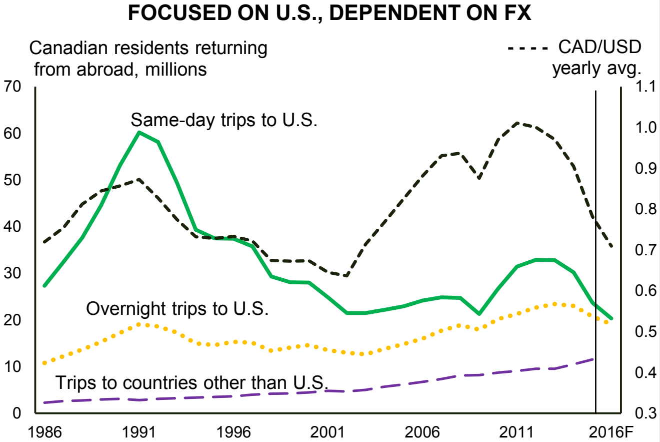
Abstracting from these structural movements, swings in the currency still tend to be the overriding driver of shorter-term trends in both visits and spending by Canadians in the United States. And, indeed, the dramatic drop in the Canadian dollar over the past 18 months – from 93 US cents to around 70 – has been leaving an indelible imprint. At last official count, Canadian total visits to the U.S. between

CHART 3: DROP IN THE VALUE OF LOONIE HAS HAD A SIGNIFICANT IMPACT ON CROSS-BORDER TRAVEL



Source: Statistics Canada, TD Economics.

CHART 2: CANADIAN TRAVEL HEAVILY FOCUSED ON U.S., DEPENDENT ON FX



Source: Statistics Canada. *2015: estimate; 2016 forecast by TD Economics.

January and November fell to around 41 million – marking a hefty 16% drop relative to the prior year and some 20% below the recent cyclical peak level of 2013. Meanwhile, over the same period, Canadian visits to non-U.S. destinations – where currencies have been more stable relative to the Canadian dollar –increased by over 10% (with Mexico, the United Kingdom, France and Cuba denoting the most popular destinations).

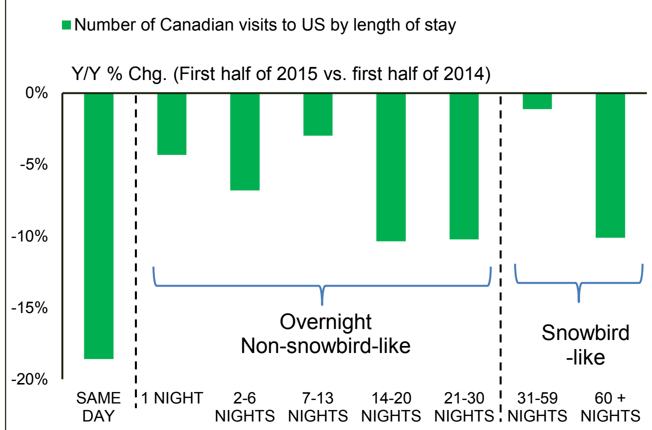
Looking under the hood, the picture has also been playing out much as one might expect. After staging a moderate rebound in the 2010-12 period, same-day visits to the U.S. fell back this past autumn to their lowest levels since the Great Recession. The number of overnight stays has also declined, but comparatively modestly (see Chart 3). That said, Chart 4 suggests that many Canadians are making some adjustments to their travel plans in order to stay within a fixed budget constraint. For example, within the snowbird category (i.e., visits exceeding 1 month), the longest-duration stays of more than 2 months dropped sharply while stays of 1-2 months remained relatively steady in the first half of the year. Many travelers have likely undertaken other forms of cost mitigation efforts – including more frugal choices on eating establishments or sources of entertainment.

Chart 5 reveals that visits to the United States are declining right across the country. In general, regions that have been hardest hit by the commodity price collapse have witnessed the most notable slide in longer-term visits stateside. One exception to that rule is Alberta, which despite falling into recession last year had recorded the second smallest drop in U.S. overnight trips during the first 11 months of 2015. However, this resilience reflects the decent momentum heading into the start of the year and the lagged hit from oil prices on spending behavior. Since the summer, U.S.-bound visits by Albertans have dropped at a more accelerated double-digit pace – indicating that the weakness in economic conditions in the province was truly starting to feed through to travel plans.

More spending in Canada by Canadians

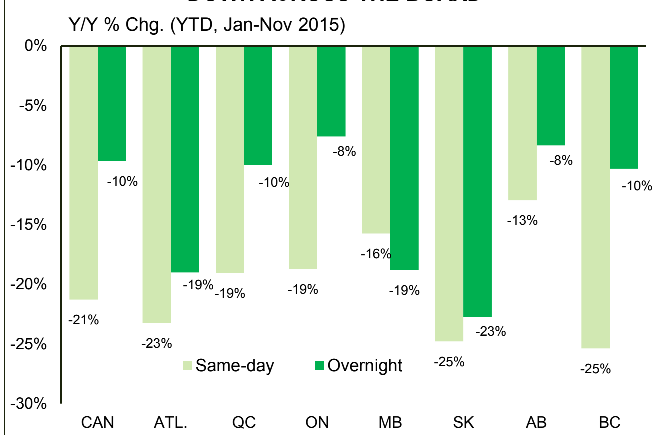
Canadian travelers are bemoaning the higher cost of U.S. trips. But few complaints are coming from Canada's retailing and travel industry. Not all of the savings from reduced U.S. travel will be redeployed to the Canadian economy. As already noted, growth in Canadian travel to non-U.S. destinations – where many exchange rates have weakened in lockstep with the loonie – has recorded faster growth since 2014. Nonetheless, a sizeable share of this windfall will be either earmarked towards travelling within Canada or spent in local retail stores.

CHART 4: ADJUSTING TRAVEL PLANS



Source: Statistics Canada.
Detailed data by length of stay available up to Q2-2015 at the time of writting.

CHART 5: CANADIAN TRIPS TO THE U.S. ARE DOWN ACROSS THE BOARD



Source: Statistics Canada.

This development is consistent with figures on tourism spending by Canadians at home, which grew at the fastest pace in two years over the first three quarters of 2015 (4% year-over-year) despite growing economic uncertainty.[1] Furthermore, some of the retail sales categories that are typically most sensitive to cross-border shopping – such as clothing and clothing accessories – have recorded a significant pickup in sales over the past year.

Expect these trends to persist in 2016

Partly reflecting the expected near-term direction of the Canadian dollar in 2016, recent trends in Canadian travel activity are likely to intensify further in the year ahead.

- The Canadian dollar is projected to average a 13-year low of 70 to 71 US cents in the first half of the year, before strengthening to 72-73 US cents by year-end in tandem with crude oil prices. That profile will still leave the average level for 2016 some 7 US cents below the comparable level in 2015.

- Canadians will increasingly shirk U.S. trips in favour of domestic and international travel. After declining by around 21% last year, daily trips are projected to fall by a further 14% in 2016, while overnight stays will continue to show considerably more resilience and likely decline by only about half that rate.
- Snowbird activity is expected to hold up particularly well given the relative affluence of this demographic group, the fact that an important share of their travel costs (i.e., lodging) tend to be fixed and the purpose of their travel (for lifestyle reasons). As the text box on page 5 discusses, the low loonie will undoubtedly bite into U.S. real estate purchases by Canadians but not derail them completely. Renting will also become a more popular option.
- Total spending by Canadians in the United States is poised to decline further. We estimate that the tally will slip closer toward the C$20 billion mark in 2016 or over C$3 billion below the 2014 level (see Chart 6). For U.S. retail and other businesses that cater to Canadians, this hides a much steeper drop (of close to $7 billion) in U.S. dollar terms over the two-year period.

An important caveat is that these projected spending levels do not factor in e-commerce activity. Unfortunately, hard data on Canadian purchases through U.S. websites are hard to come by. In 2012, the total value of online orders for goods and services placed by Canadians was estimated at C$19 billion, although that included purchases from both domestic and U.S./foreign retailers.[2] Since then, this tally has probably topped C$25 billion.[3] Given that more than three in five Canadians surveyed purchased goods from U.S. stores – and in light of the comparative advantage that U.S. retailers have enjoyed in terms of price, product selection and internet client experiences – the U.S. share of total online spending by Canadians is significant. Case in point, an estimate based on postal and courier import data pegged online purchases of U.S. goods alone at just over C$3 billion in 2012 or as much as 40 percent of total cross-border shopping.[4]

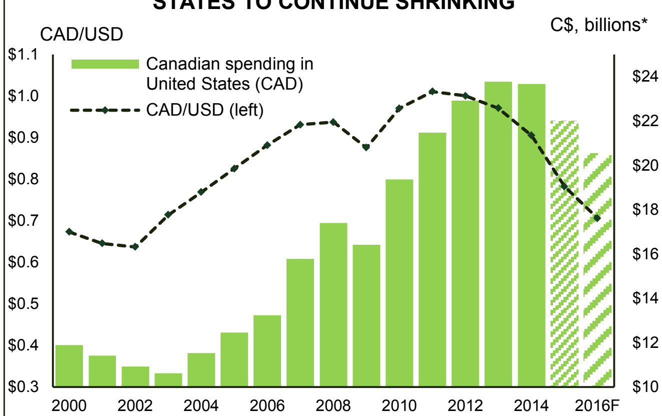
While the longer-term upside to e-commerce activity remains impressive, online purchases are likely highly sensitive to cyclical movements in the Canadian dollar. As such, the ongoing weakness in the loonie will probably lead to a parallel fall-off in Canadians shopping activity on U.S. websites this year, marking an opportunity for Canadian-based websites to gain some market share.

Americans dusting off their Canadian maps

Still, another significant economic boost is likely to flow from an influx of U.S. tourists into Canada. This makes up the other side of the coin. The weakening Canadian dollar – alongside improving U.S. consumer spending fundamentals – has fueled a sharp pickup in American spending in Canada.

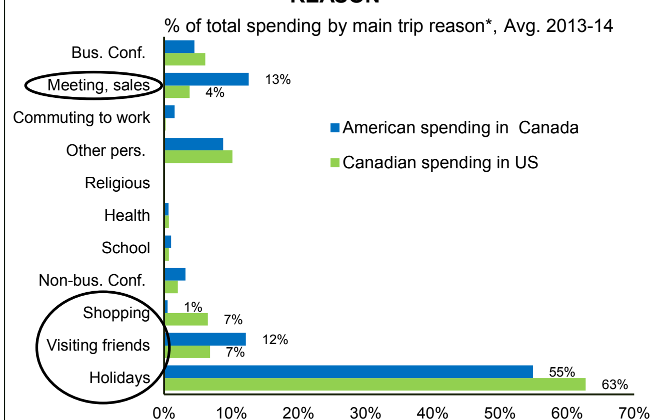
With much of the spotlight on shifts in Canadian travel, considerably less is known about U.S. travel behavior in Canada. A comparison of the data highlights some notable distinctions. Vacationing is the primary reason for cross-

CHART 6: CANADIAN SPENDING IN THE UNITED STATES TO CONTINUE SHRINKING



Source: Statistics Canada. *2015:expected; 2016: forecast by TD Economics; spending less fares. Pre-2013 data re-indexed by TD Economics for illustrative purposes.

CHART 9: DIFFERENCES IN SPENDING BY TRIP REASON



Source: Statistics Canada. For comparative purposes, the total excludes the following: On diplomatic or military orders, seasonal worker, other business reasons, in transit to/from other countries. *Spending less fares.

U.S. REAL ESTATE: A BARGAIN NO MORE?

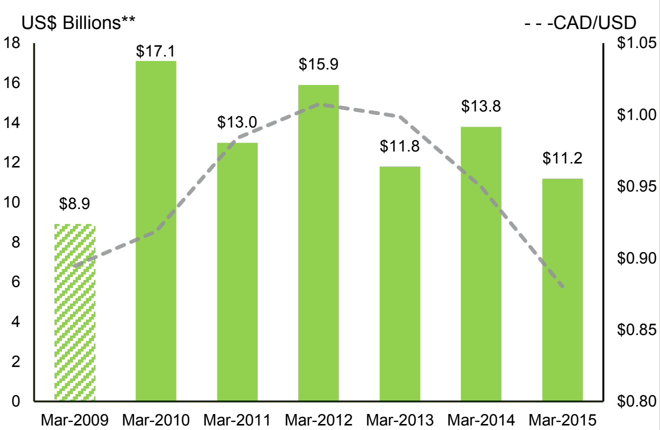
The financial meltdown of 2009 caused U.S. real estate prices to plummet. Together with the growing value of the loonie, affordability to Canadians rose by close to 60% (peak-to-trough) in markets like Florida and Arizona which are popular destinations for snowbirds. Canadians took advantage of these low prices, purchasing homes worth roughly US$83 billion in a span of just 6 years following the recession (see Chart 7) – some of which have been subsequently resold along the way. Many of these purchases were driven by lifestyle choices, investment considerations or – as typically is the case – a combination of the two. In the 12 months through March 2015, nearly half of all properties purchased by Canadians in the U.S. were for vacation purposes.[5]

Now that visiting the U.S. has become more expensive, the lure of selling these properties is strong – particularly since it would provide additional returns if the funds were to be converted back into Canadian dollars. Some are already cashing in. However, there are two main reasons why many won't take that route. First and foremost, it would likely result in a lifestyle change and most owners (particularly snowbirds) will be inclined to continue living a lifestyle that they have become accustomed to. Secondly, from an investment perspective, American home values in popular snowbird markets are expected to continue rising at a decent-to-solid pace; and any income earned on these properties can be used to ease the increased costs due to the exchange rate.

On the other hand, new home purchase activity is likely to suffer markedly as prospective buyers face rapidly rising prices. After factoring in the steep decline of the loonie last year, home prices in states like Florida and Arizona were roughly 24 and 21 percent higher on average from 2014 levels (up 7 and 4 percent respectively in US dollar terms; see Chart 8). As prices continue to rise, renting is likely to become an increasingly practical alternative.

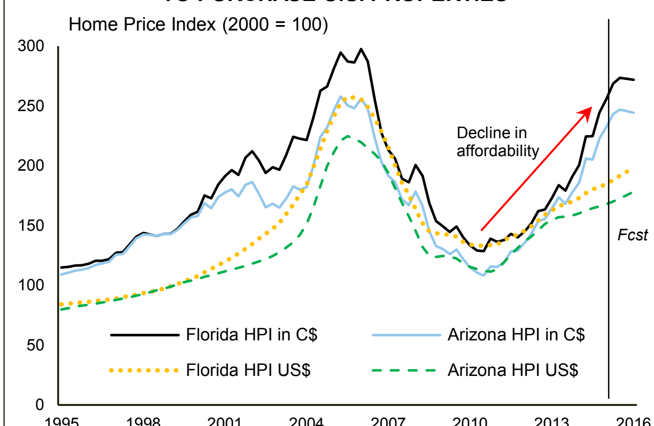
But not all hope is lost for those still looking to own their nest. The large American market has a wide selection of properties, many of which are still below their pre-recession peaks. To score a bargain, snowbirds will need to explore new territories outside of the traditional centers that they have been flocking to for years. Prospective snowbirds are also expected to benefit from developments in banking. Obtaining a mortgage from a U.S. bank has been historically difficult for foreigners, so most Canadians have had to pay largely in cash. In the 12 months ending in March 2015, about 73% of all Canadian real estate purchases in the U.S. were 'all cash' while only 23% had mortgage financing.[6] These properties cost an average of US$380,000 – a hefty lump-sum even for some of the wealthier snowbirds. With the expansion of some Canadian banks in the U.S. it is becoming easier to obtain mortgages, since one's financial history and assets in Canada may be taken into account.[7] This alternative should help support Canadian home purchases in the U.S. especially as Canadians become more familiar with it.

CHART 7: VOLUME OF U.S. REAL ESTATE PURCHASES BY CANADIANS



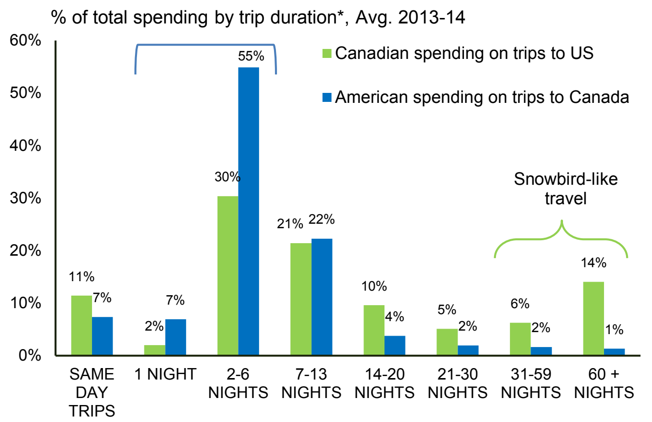
Source: National Association of Realtors. *2009 includes only non-resident clients.
** 12 months ending in March of each year; value of loonie adjusted for same period.

CHART 8: WEAKER LOONIE MAKING IT HARDER TO PURCHASE U.S. PROPERTIES



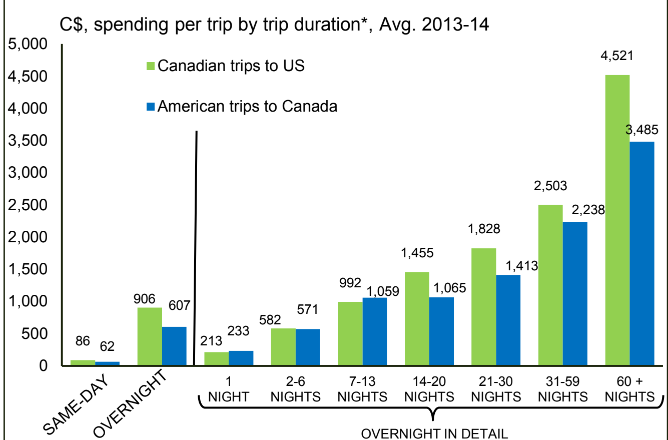
Source: Corelogic, Moody's Analytics. Forecast by TD Economics.

CHART 10: AMERICAN SPENDING IN CANADA HEAVILY CONCENTRATED ON STAYS OF 1-6 NIGHTS



Source: Statistics Canada. *Spending less fares.

CHART 11: CANADIANS TEND TO SPEND MORE PER TRIP COMPARED TO AMERICANS



Source: Statistics Canada. *Spending less fares.

border travel in both directions, but especially among Canadians heading south. Shopping also features much more prominently as a reason for travel among Canadians, while visiting family and friends and to carry out business tends to be a more popular reason for U.S. trips to Canada than vice versa (see Chart 9).

The differences in purpose of travel also translate into variations in length of stay in each country. Shopping underpins the relatively high frequency of daily trips south of the border, while business and social trips north of the border are consistent with longer stays of 1-6 nights as the most frequent choice. Moreover, with no real American equivalent to "Canadian snowbirds", long-term stays in Canada by Americans are not nearly as prevalent (see Chart 10). American spending in Canada also tends to peak during the summer months and bottom during the winter, while Canadian spending in the U.S. peaks in the spring and troughs in the fall.

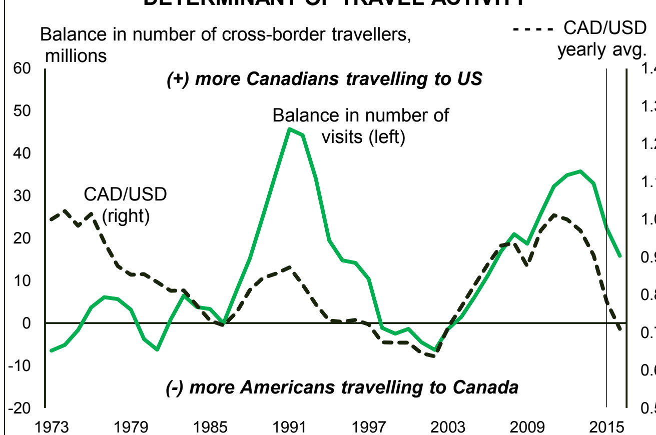
Lastly, Canadians tend to spend more per trip on both daily and overnight visits than their American counterparts – an additional C$25 and C$300 respectively over 2013-14 (see Chart 11). While higher Canadian spending on daily visits is partly a reflection of shopping patterns, higher spending on overnight stays can be mostly chalked up to differences in the duration of stay. Canadians spend significantly more time in the U.S. (on average 10 person-nights per trip) than Americans spend in Canada (just over 4 person-nights per trip during 2013-14). The disparity is emphasized for trips longer than 14 nights where Canadians also tend to spend slightly more per night.

Why the cold shoulder?

In 2014, Canadian visits stateside outnumbered American visits to Canada by an astounding 33 million. That balance is expected to have fallen to just over 22 million last year due to the sharp depreciation of the loonie. With an estimated 38 million Americans living within 160 kilometers of the border, this result may seem perplexing at first.[8] But it hasn't always been this way. As recently as 15 years ago, the gap was flipped, with more Americans visiting Canada (see Chart 12).

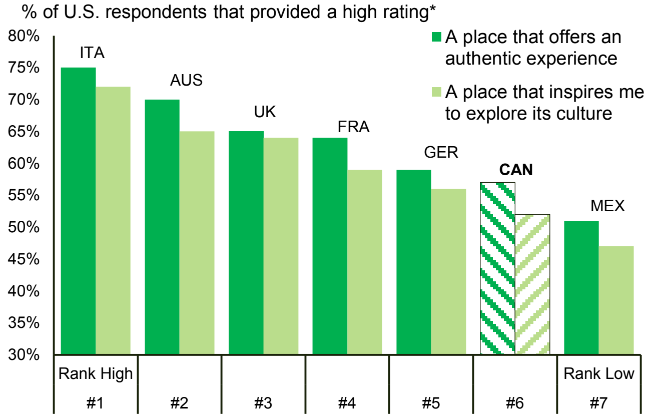
That time of historically strong U.S. travel to Canada had followed a period of economic boom-times and elevated currency south of the border. A series of headwinds has since put the cold chill on U.S. in-bound visits. As the U.S. dollar embarked on a steady slide in the 2003-08 period, Americans began lamenting that Canada was "no longer on sale".[9] Add to that a sharp rise in gasoline prices, rising

CHART 12: VALUE OF CURRENCY, BIG DETERMINANT OF TRAVEL ACTIVITY



Source: Statistics Canada. *2015: estimate; 2016 forecast by TD Economics.

CHART 13: BRAND PERCEPTIONS - CANADA SCORES LOW IN SOME AREAS



Source: Global Tourism Watch, 2014 USA Summary Report.
*High rating: rated 8-10 on a scale of 1-10.

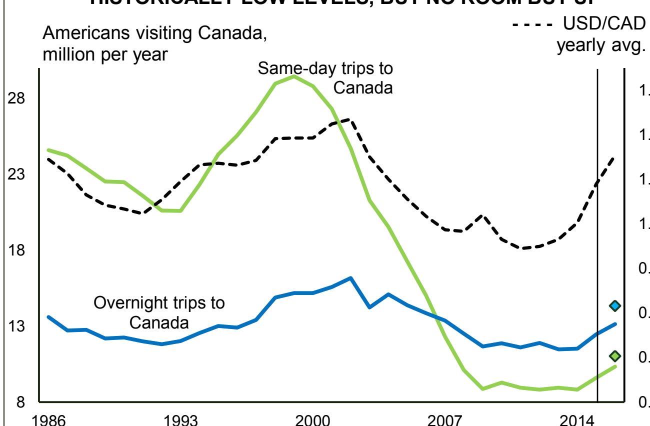
border security following 9/11, and last but hardly least, the advent of the Great Recession which dealt a heavy blow to U.S. household wealth, jobs and spending. Even as the U.S. economy recovered following the crisis, personal income was slow to recover. Worse still, Americans surveyed in recent years have placed Canada relatively low on the list in terms of desirability of vacation spots (see Chart 13). Canada's reputation as a land of natural beauty and spectacular scenery tends to resonate more among older visitors and less among millennials. A lack of new high-profile attractions in Canadian cities may be a contributing factor to these disappointing survey results.

In 2014, the number of U.S. visits to Canada hit its lowest level on record. But with the U.S. dollar beginning to gain some traction that year, improvements were recorded in the average length of stay and spending per trip rose. Additionally, a continued surge in the U.S. currency and firming in job markets started to show up in higher U.S. visits to Canada, while special events – such as the FIFA Women's World Cup and the 2015 Pan Am & Parapan Am Games – provided an added fillip.

An additional 1.6 million Americans entered Canada between January and November 2015 compared to the same period in 2014, equivalent to a rise of over 8%. Although the number of visitors is increasing, it remains well off the peaks reached in the late 1990s and early 2000s (see Chart 14). And while those levels are unlikely to be tested in 2016, we do see further ground being made up:

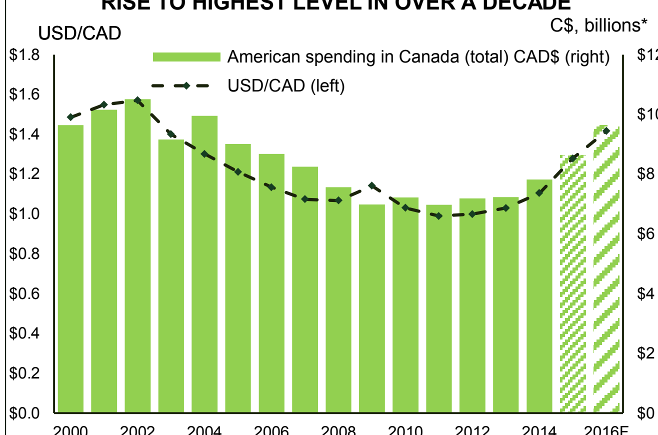
- Total American visits to Canada are likely to grow over 6% this year, pushing up U.S. spending to around C$9.6 billion. This would represent a gain of almost C$2.5 billion from the recent low watermark of 2013 and its highest level in over a decade (see Chart 15).
- This rise in American spending, combined with a decline in Canadian spending stateside, is projected to narrow the cross-border spending gap by around C$5 billion in 2016 relative to the 2014 level. The Canadian economy will not reap all the benefits of this swing in fortunes, as some of the spending that would have occurred in the U.S. will be saved or spent in other parts of the world. However, $4-5 billion could still be considered a decent gauge of the cumulative direct economic boost to Canada over the 2015-16 period. This is not a massive game changer, but it certainly provides some underlying support to an economy where growth has been sorely lacking of late.
- While most economies across the country are likely

CHART 14: AMERICAN TRIPS TO CANADA STILL AT HISTORICALLY LOW LEVELS, BUT NO ROOM BUT UP



Source: Statistics Canada. *2015: estimate; 2016: forecast by TD Economics.
◆ Diamonds denote a very optimistic 'hypothetical' scenario of visits rising by 15% in 2016 - this would still leave the number of visits well below prior peaks.

CHART 15: AMERICAN SPENDING IN CANADA TO RISE TO HIGHEST LEVEL IN OVER A DECADE



Source: Statistics Canada. *2015:expected; 2016: forecast by TD Economics; spending less fares. Pre-2013 data re-indexed by TD Economics for illustrative purposes.

to benefit from higher spending, some are particularly well positioned. Relative to the size of their economies, British Columbia, New Brunswick and Ontario have tended to be the provinces most reliant on U.S. tourist spending. The beleaguered oil-producing regions that are struggling under the weight of low crude prices don't appear to be seeing an influx of U.S. visitors. However, the aggregate travel figures are likely heavily skewed by decreased business travel. Looking past this, additional tourist dollars should still provide a much-needed boost to growth, though residents of these regions are likely to save a larger share of their reduced U.S. travel spending rather than spend it locally.

Bottom line

Over the last few years, cross-border flows of spending have been heavily tilted toward the south. However, the tide has begun to shift, as the declining Canadian dollar has been weighing on the number of Canadian visits to the U.S. and stimulating more American visits to Canada. We see little stopping a continuation of this trend in 2016, providing a modest but welcome tailwind to Canada's economic growth.

Derek Burleton, VP & Deputy Chief Economist
416-982-2514

Admir Kolaj, Economic Analyst
416-944-6318

End Notes

1. Nominal; excludes spending on transportation (which has fallen due to lower fuel costs); includes spending on accommodation, food and beverage, and other tourism commodities.
2. Statistics Canada, Individual Internet use and e-commerce (see link).
3. Forrester Research, "Canada Online Retail Forecast", (Excludes categories such as cars, prescription drugs, food and drink sales at a restaurant or fast food chain, consumer-to-consumer commerce, and gasoline sales).
4. Corbi, P.; Statistics Canada, "Estimates of Cross-Border Shopping 2006-2012", 2014. Postal and courier imports tend to be ordered online; includes some imports from countries other the U.S.; medium scenario (see link).
5. Profile of International Home Buying Activity, NAR, 2015, page 26.
6. Profile of International Home Buying Activity, NAR, 2015, page 27.
7. For example: TD Bank, Cross-Border Banking (see link).
8. Thompson, C. Wayne, "Canada: The World Today Series, 2015-2016" 31st edition, pg.18; "...12% of [Americans] live within 100 miles of the Canadian border".
9. Canadian Tourism Commission, "U.S. Travel Market Behavioural Study", 2008 (see link).