

Canada/U.S. Price Gap & Cross-Border Shopping

And you thought the line-ups to get into the United States were long before. A culmination of factors is likely to lead to a notable upswing of Canadians cross-border shopping this summer, in numbers not seen in two decades. There are already more than 50 million visits to the U.S. by Canadian residents annually (or about 1.5 a year for every man, woman and child).

Starting next month, the duty-free limit for stays of more than 24 hours will be markedly boosted to \$200 from \$50, while any visit above 48 hours will be hiked to \$800 (from a two-tier rate of \$400 up to a week, and \$750 beyond a week). These allowances would not be an issue if there wasn't a compelling lure for Canadians to cross the border. But, even with a dip in the loonie in recent days to just below par, there is still a very powerful magnetic pull from the south. Our latest random sampling of a basket of goods finds that Canadian retail prices are roughly 14% above U.S. levels, before taxes and adjusted for the exchange rate (*Table 1*). The price gap is down from last year's 20% differential, partly due to a slightly softer Canadian dollar (it was \$1.02 a year ago), and partly reflecting slightly slower Canadian core inflation in the past year. We also found that a previously enormous price spread in one specific item (gas barbecues) has all but vanished on price reductions in Canada. However, the unusual differential on running shoes, highlighted last year, persists.

The price gap we find typically aligns well with the spread between the current exchange rate and estimates of purchasing power parity (PPP, or the exchange rate that would equalize prices between countries). For instance, last year's 20% price gap was quite close to the spread between the exchange rate at the time and the OECD's PPP estimate of 81.3 cents(US) for 2011 (*Chart 1*). While the PPP for the loonie tends to be very stable over time in a range between 80-to-85 cents, the currency itself has bounced around wildly in the past decade in a range of 62-to-110 cents. Given the volatility of recent years, it is little surprise that we have also

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TABLE 1
COMPARISON SHOPPING

Item	Cdn. Price (C\$)	U.S. Price (US\$)	U.S. Price (in C\$-terms)	Price Gap (percent)
Magazines (sample 4)	6.49	5.49	5.53	17
Blu-ray Movies (sample 4)	21.69	19.98	20.12	8
Running Shoes (sample 5)	145.99	105.99	106.73	37
Books (sample 4)	21.86	20.22	20.36	7
Cars (sample 7)	35,618	31,957	32,181	11
BBQs (sample 4)	912.50	925.00	931.48	-2
Toro Lawn Mower	479.00	359.00	361.51	32
DeWalt Cordless Drill Kit	309.00	299.00	301.09	3
Keurig Single-Serve Coffee Maker	129.99	119.99	120.83	8
Nike + iPod Sensor	25.00	19.00	19.13	31
Titleist ProV1 Golf Balls	53.99	47.95	48.29	12
Quicksilver Boardshorts	59.99	58.00	58.41	3
Canon Rebel T3 Camera	529.99	499.99	503.49	5
Huggies Little Movers	39.97	34.75	34.99	14
Gap Kids T-Shirt	29.95	24.95	25.12	19
Pottery Barn for Kids Backpack	43.90	34.50	34.74	26
Bliss Face Wash	25.00	24.00	24.17	3
Birthday Card	5.45	4.95	4.98	9
Average				14

Using US\$/C\$ exchange rate of \$0.9930

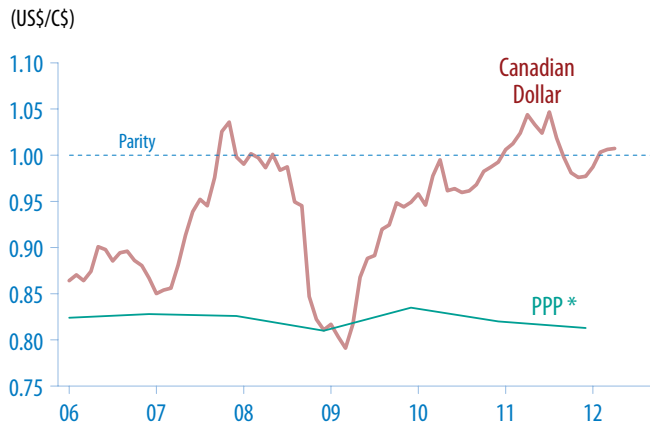
seen some occasionally hefty price gaps (peaking at almost 25% in the fall of 2007).

The upshot is that Canadian visits to the U.S. are expected to accelerate again, especially for periods of more than 24 hours. Border delays and hassles, the high price of gas, the availability of online shopping, and the passport requirement for trips to the U.S. have kept same-day visits below the peak levels of the early 1990s (when the GST was introduced and the currency was also strong). But aside from that period, there have never been more Canadians heading south than now (*Chart 2*). On the flip side, there have never been fewer U.S. visitors to Canada, a significant hit to our tourism industry. While stays of more than 24 hours are not at record lows, overall visits by Americans are now running at the lowest level in more than 40 years of records. There are now 2.7 Canadian visits to the U.S. for every U.S. visitor to Canada, whereas the ratio was 1:1 from 1995-to-2005.

The steady drain of Canadian shoppers heading south is weighing on retail sales in this country. For the first time in years, U.S. retail sales growth is running faster than in Canada (*Chart 3*). The better spending growth backdrop stateside is no small irony, given the wave of U.S. retailers heading north to seek greener pastures. Research by the Bank of Canada finds that cross-border shopping accounts for less than 2% of consumer spending, and is thus likely not a major macroeconomic issue. However, we would note that these are official estimates and likely vastly understate the actual amount spent in the U.S. Second, we would also note that roughly half of all spending is captive, and could not possibly be imported (rent, utilities, child care, communications, etc). Taking those factors into account, we would estimate that cross-border spending may, in fact, account for as much as 8%-to-10% of all outlays on items that can be moved across borders. If correct, that represents a real drain on domestic retail sales, employment, and government revenues; a drain that looks to deepen.

Endnote: The exercise of price comparisons across borders is not always straightforward. Many published materials do not openly show both Canadian and U.S. prices, while a number of products have tiny differences in

CHART 1
LOONIE SOARS ABOVE PPP



* Purchasing Power Parity estimate for the C\$ (OECD)

CHART 2
CROSS-BORDER TRAVEL: ONE-WAY FLOW

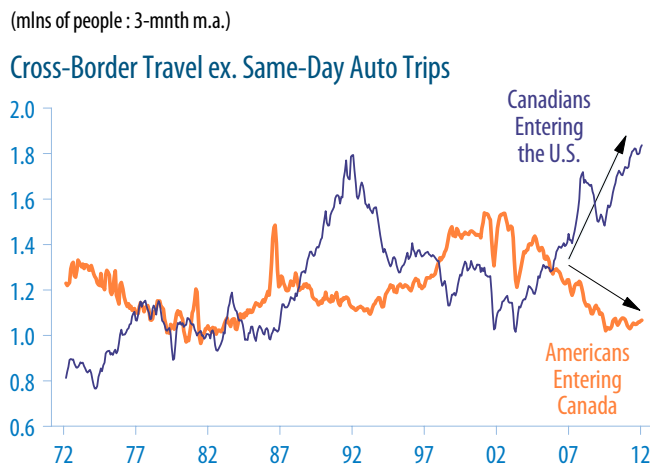
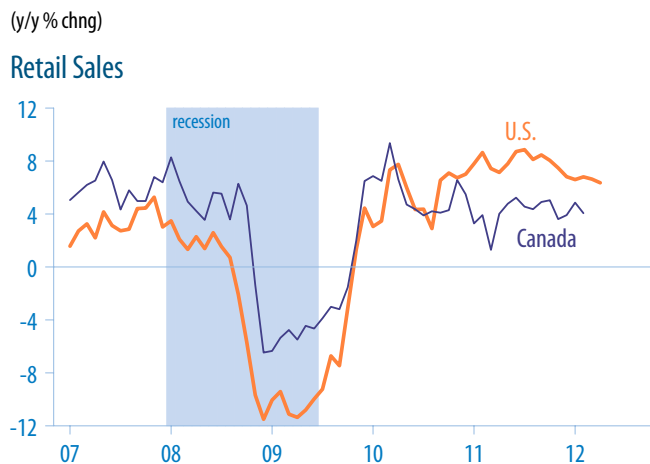


CHART 3
WHERE THE WILD SHOPPERS ARE...



specifications between Canada and the U.S. Wherever possible, we compared apples to apples, all from similar retail outlets, and before taxes. We do not pretend that this is an exact science, but more a representative basket of goods that a typical Canadian shopper may compare. Thanks to the team of bargain hunters—Carl Campus, Robert Kavcic, Jennifer Lee, and Benjamin Reitzes.

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