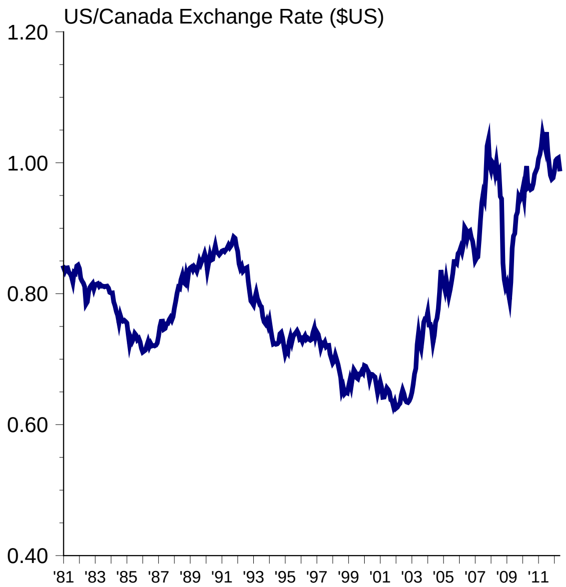
Is Cross-Border Shopping on the Rise?

By Dan Schrier

Since bottoming out at under 63 cents U.S. in early 2002, the Canadian dollar has experienced substantial appreciation, such that in the last couple of years it has been hovering around par with its American counterpart.

In the last decade, the Canadian dollar has appreciated substantially relative to its American counterpart

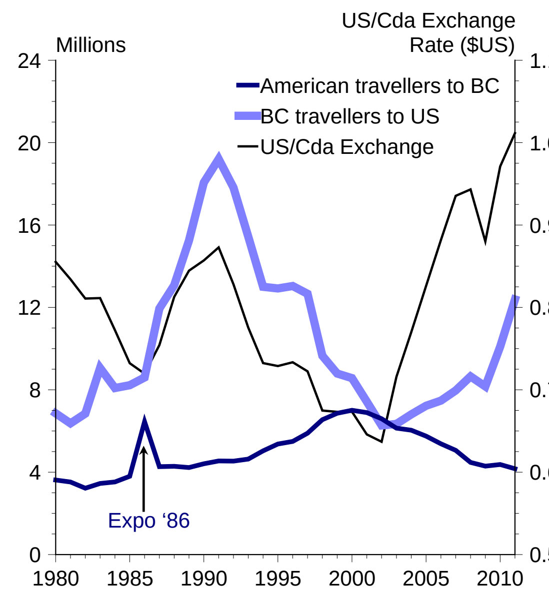


Source: Pacific Exchange Rate Service

While most attention seems to be paid to the negative aspects of a high dollar, there are actually a number of benefits to a strong Canadian currency. First and foremost, a strong dollar generally signifies a healthy economy, at least relative to other countries. It also helps keep interest rates low, which can be a benefit to both businesses and consumers. In addition, prices of imports are lower, which, combined with low interest rates, makes it much more affordable for Canadian manufacturers to make upgrades to machinery and equipment.

Nevertheless, there are some sectors for which a high Canadian dollar can be problematic. For example, Canadian retailers located near the Canada-U.S. border may have trouble competing with operations south of the border when the Canadian dollar is around par or better against the American greenback. The data show that at times when the Canadian dollar has undergone significant appreciation, there have been large increases in travel by British Columbians to the United States. The exchange rate has far less of an effect on American travel to British Columbia.

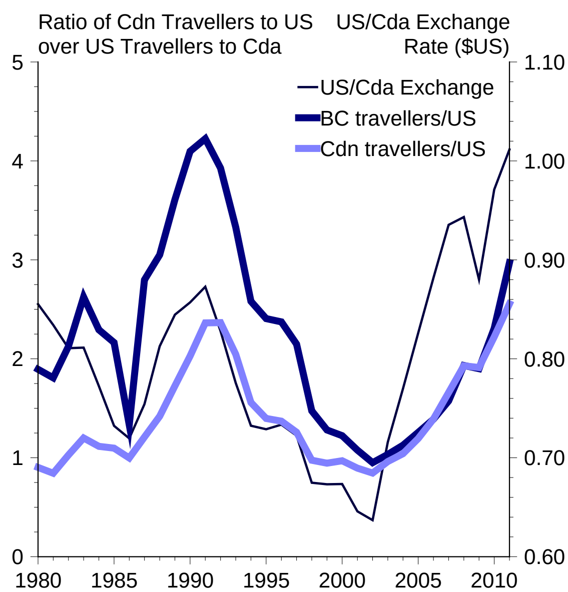
The exchange rate has a far more significant effect on the volume of travel from B.C. to the U.S. than vice versa



Source: Statistics Canada

In the years when the Canadian dollar was sitting at historical lows, the ratio of Canadians visiting the U.S. over Americans visiting Canada was more or less one-to-one. In the years when the loonie was valued at around US 85 cents or higher, that ratio climbed to more than two-to-one for Canadians as a whole, and up to four-to-one for visitors from B.C. to the U.S. compared to Americans visiting British Columbia.

When the Canadian dollar is near par with its American counterpart, there are far more Canadian travellers to the U.S. than vice versa

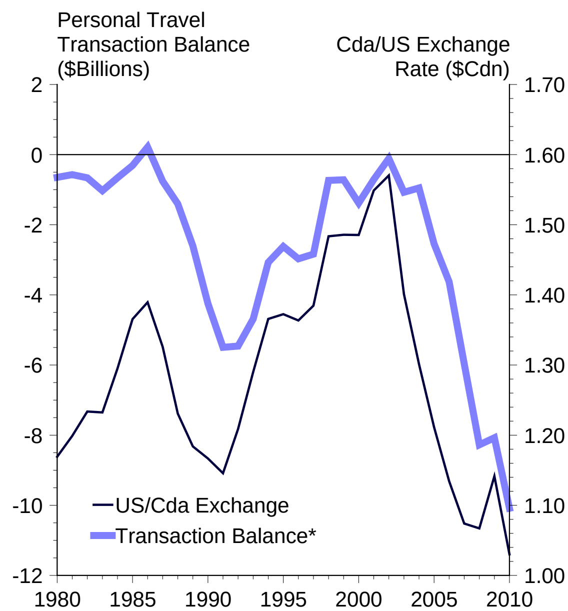


Source: Statistics Canada

Given the higher volume of Canadians travelling south compared to Americans travelling north, it is not surprising to see that personal travel expenditures by Canadians in the U.S. are considerably higher than the corresponding expenditures by Americans visiting Canada. In 2010, the difference amounted to $10 billion, at a time when the Canadian dollar was flirting with par with its American counterpart.

With around 60 percent of Canadian travel to the United States consisting of people returning to Canada the same day, one can speculate that at least a portion of these travellers are visiting the U.S. for the purpose of engaging in cross-border shopping. As such, some of the money spent by Canadians in the U.S. is likely attributable to this purpose as well.

With a dollar near par, Canadian travellers (excluding business) are spending far more in the US than Americans are spending in Canada



Source: Statistics Canada
*Personal travel expenditures by Americans in Canada minus spending by Canadians in the US

Despite the fact that in the last few years the loonie has been at or above par with the greenback, the number of visits by Canadians to the U.S. has not reached the levels seen in the early 1990s when the Canadian dollar was worth only around US 85 cents. There are a number of possible explanations for this. One reason may be the increased hassle associated with crossing borders given the enhanced security measures in a post-9/11 world. In addition, since the early 1990s, many American retailers have established a presence in Canada, offering Canadians increased variety in the goods available on the northern side of the border. The more broad-based adoption of e-commerce has also offered Canadians the opportunity to purchase goods from the U.S. or other international retailers without leaving home.

However, a loonie that has been persistently at or above par over the last year, combined with price stickiness on the Canadian side of the border, such that Canadian prices are often still well in excess of corresponding American prices, has led to a ramp-up in visits by Canadians to the United States, particularly on same-day return trips. One has to assume that cross-border shopping is one of the main activities of a large portion of these trips.

Retailers in Canada have responded to criticism over the price differentials by pointing out a number of reasons for higher costs in Canada. These include federal import duties, higher transportation costs and the fact that multinational distributors are charging Canadian retailers more than their American competitors.

These may be valid reasons, but ultimately the consumer will decide where to buy based on where they can get the best value for their money. If Canadian retailers are unwilling or unable to adjust their prices, it is possible they will see their customer base shrink. Starting June 1st, Canadian duty-free limits were raised,[1] which could further impact Canadian retailers, although duty-free limits only kick in after a minimum 24-hour stay, so it shouldn't impact same-day cross-border shopping. Nevertheless, it is one more challenge that retailers in Canada will have to face.

[1] For stays of 24–48 hours, the limit climbed from $50 to $200; for stays longer than 48 hours, the limit was raised to $800, up from $400 for visits less than a week and from $750 for visits of seven days or more.