OBSERVATION
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A FLOCK OF SNOWBIRDS AND A FALLING LOONIE

Cross-border shopping to fall but snowbirds to keep flying south

Highlights

- Each year, some 23.5 million Canadians visit the United States, injecting about C$22.3 billion into the U.S. economy. About 80% of the visits are either overnight or same-day trips.
- Our analysis suggests that the drop in the Canadian dollar will reduce the number of visits by about 3 million in both 2014 and 2015 and lower total spending by some C$4.5 billion.
- The decline is expected to be concentrated among short-term visits to the United States. On the plus side, Canadian retailers located within close proximity to the U.S. border are likely to benefit from much of this spending remaining at home. In addition, U.S. traffic to Canada is likely to increase relative to recent years.
- By some estimates, there are more than 500,000 Canadians that spend significant periods of time in the United States – the so called snowbirds. In contrast to short-term visits, we do not expect to see a significant negative impact on longer-term stays by Canadians in the United States. Snowbird behaviour tends to be driven by lifestyle choices.
- Canadian snowbirds have been accumulating significant U.S. real estate over the past decade. The combination of a lower Loonie and rising U.S. home prices will put a dent in new purchases of U.S. real estate by Canadians. Renting in the U.S. will become a more alluring option.
- At the same time, existing snowbirds are unlikely to unload their U.S. properties in markets where home values continue to appreciate.

Changes in the value of the Canadian dollar tend to generate winners and losers. In the losing camp are the many Canadians that head to the United States each year, including the many snowbirds and cross-border shoppers who go to score bargains. Chart 1 shows that not only is the amount spent by Canadians in the United States significant, but it has also been growing rapidly over the past several decades. Last year, some 23.5 million Canadians visited the U.S., spending C$22.3 billion during their trips. These figures are more than double their levels of ten years ago.

In this report, we attempt to put a finger on how the Loonie's recent – and likely future – descent will impact Canadians' desire to visit the United States. Our analysis suggests that the drop in the currency since late 2012 – which we peg at about 15% once the Loonie likely reaches bottom by mid-2014 – will reduce the number of visits to the U.S. by about 3 million in both

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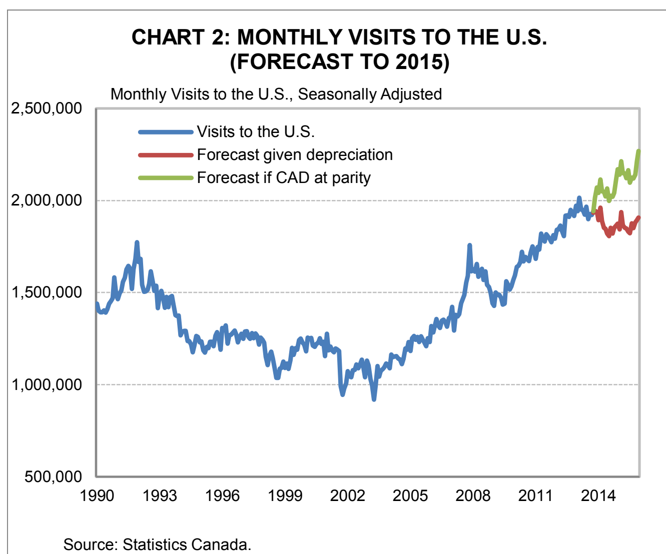
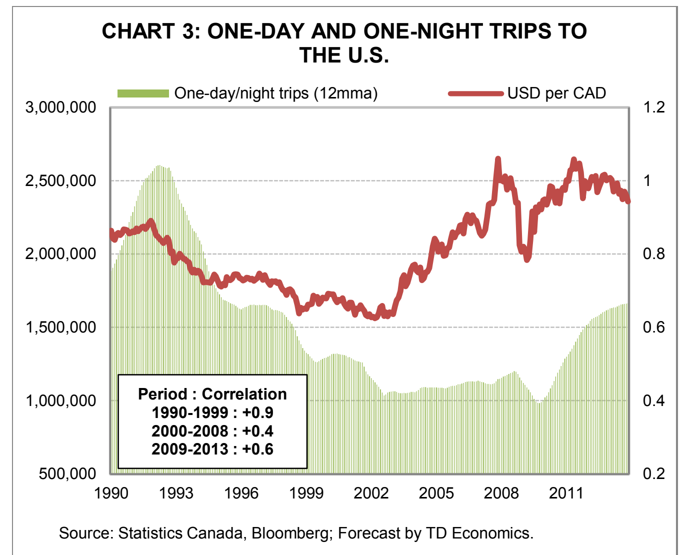
2014 and 2015 and lower total spending by Canadians in the U.S. by some C$4.5 billion. Put another way, whereas we would have expected continued growth in the 2014-15 period, both visits and total outlays are likely to edge lower (Chart 2). While this reduced activity represents a rounding error for the U.S. economy as a whole, it will have more of an impact on the economies of cities by the border such as Burlington, Detroit or Seattle. On the flip side, Canadian retailers and communities stand to benefit as much of this "lost" spending will likely take place within the domestic Canadian market.

Short-term visits are highly C$ sensitive

Of the total crossings by Canadians each year, about 80% are either same-day or overnight trips. These short-term visits serve as a good approximation of cross-border shopping patterns. By and large, cross-border activity has historically been sensitive to swings in the Canadian dollar. Still, as chart 3 highlights, there are periods where there can be a breakdown in this relationship. Despite the Canadian dollar's sharp appreciation much of this past decade – one that greatly improved the economics of travelling south of the border – the number of visits remained fairly flat until 2008. Part of the weak responsiveness to the Loonie's strength can be partly chalked up to rising/high gasoline prices over the period. The more important dampening influence appeared to be tighter border security following the 9/11 terrorist attacks, which led to significant border delays. As Canadians expected longer wait times at customs, the incentive from a more robust Canadian dollar was not sufficient to spur visits, but likely prevented a more marked decrease.

Indeed, a study[1] by the University of British Columbia estimated the 9/11 effect to have reduced same-day crossings by about 32%, holding all else equal. It also found that overnight trips (as opposed to single day) were not significantly impacted, which indicated that the inconvenience of tighter border controls was largely ignored for visits of a longer nature.





Another setback for short-term visits occurred during the 2008-09 global economic crisis. Worsening economic conditions and a depreciating Loonie created the perfect storm that brought down short-term visits to their historical lows.

Since the end of the 2008-09 recession, the number of same-day and overnight visits to the United States by Canadian residents has made up for some lost time, rising by a spectacular 50% over the period. Increased border efficiency and simpler passage for frequent travelers with the advent of NEXUS have helped to ease border delays. In its 2012 budget, the federal government raised the amount Canadians could bring back duty-free from the U.S., which provided further support to Canadian cross-border flows. Above all, the appreciation of the Canadian dollar may have also taken time to sink in for consumers. A particular milestone was reached when the Loonie reached parity in 2008, as it made prices on both sides of the border more easily comparable and exposed steep discounts for U.S. goods – as much as 20% on average.

Lower C$ starting to weigh on short-term visits

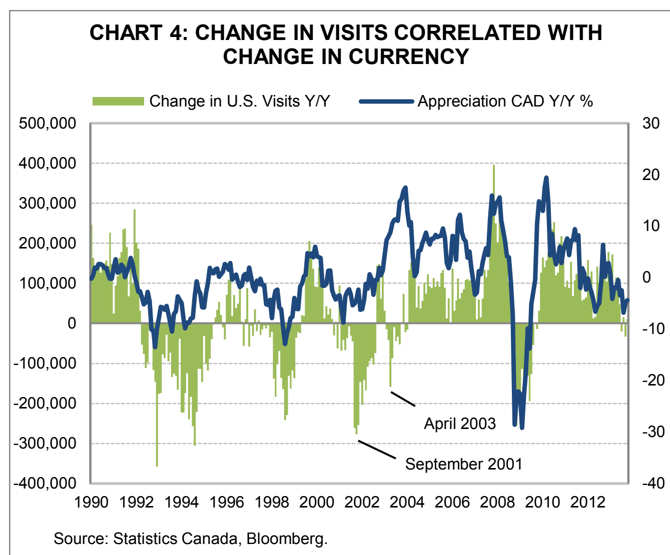
Chart 3 shows that the depreciation in the Canadian dollar since late 2012 has started to bite on short-term visits, as the upward trend has tapered off. We anticipate that as the Canadian dollar's decline continues, and as the lagged impact of past moves intensifies, the number of Canadians

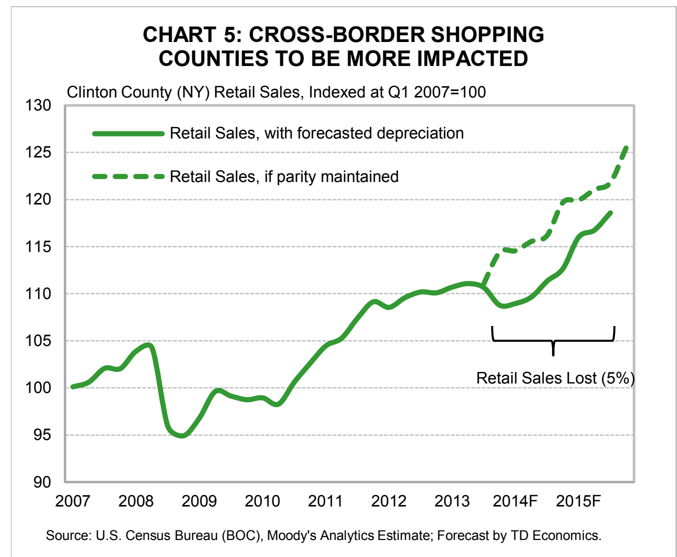
entering the U.S. for short-term trips will head lower – by as much as 15% over the next two years relative to their levels had the Loonie stayed at par. Spending on these stays will likely decline by roughly the same magnitude.

Yet, as the chart shows, the level of activity is likely to remain high. One mitigating factor is the persistence of a price gap between Canadian and U.S. goods. The run-up in the currency and pressure on Canadian retailers to pass those savings onto consumers has narrowed the price gap over the past few years. Still, it has been estimated that Canadian prices remain about 9% higher on average compared to U.S. prices, after adjusting for the exchange rate. This differential might begin to widen once again as retailers in Canada move to pass onto consumers some of the cost imposed on them due to the weaker Canadian dollar on imported store goods, machinery and other inputs. The Canadian federal government has accused wholesale distributors of goods as applying country pricing that discriminates against Canadians and has vowed to eliminate it, although how it will achieve this goal remains unclear.

Border communities to be most affected

The impact of reduced short-term visits by Canadians on U.S. local economies will depend largely on their proximity to the border. Several studies point to a quickly vanishing propensity to shop in another country as distance increases. Some of these economies that are expected to be harder hit include the U.S. counties of Erie (Buffalo NY), King County (Seattle WA), Chittenden (Burlington VT) and Clinton (Plattsburgh NY). These counties have received a sizeable share of business from Canadians looking for deals south of the border and are also located close to Canada's three largest cities. Our model shows that a municipality like Clinton County (population 82,000) stands to lose as much as 5% of their overall business, which would slow their recovery as Canadians spend less of their money in the U.S. (Chart 5).





In order to give an idea of just how integrated to Canada these economies have become, Burlington VT passed a resolution in 2011 recommending all signs to be in both English and French, a way to accommodate and attract tourists and shoppers from Québec.

For Canadian retailers located close to the border, the currency's decline stands to be a net positive, since it suggests some of the spending that otherwise would have moved southward will remain in Canada, while U.S. traffic is likely to pick up. Canadian retail markets that are well positioned to benefit include St. Catharines, Hamilton, Windsor, Sherbrooke and Abbotsford. However, as we've already pointed out, part of this advantage for the Canadian retail industry will be eroded by pressure of retail margins flowing from higher import costs.

Snowbirds to keep flying south

In contrast to short-term stays, one aspect of Canadian tourism spending in the U.S. that is unlikely to be greatly affected is snowbird activity. Estimated at more than half a million, these cold-fleeing Canadians typically leave for southern U.S. states for 3-6 months every year. In contrast to short-term visits to the U.S., which struggled to take off during the Canadian dollar appreciation of the mid-2000s, these longer-term stays recorded uninterrupted growth since 2002 (Chart 6).

Florida is Canada's most popular destination for extended visits. In 2012, more than 3.5 million Canadians spent

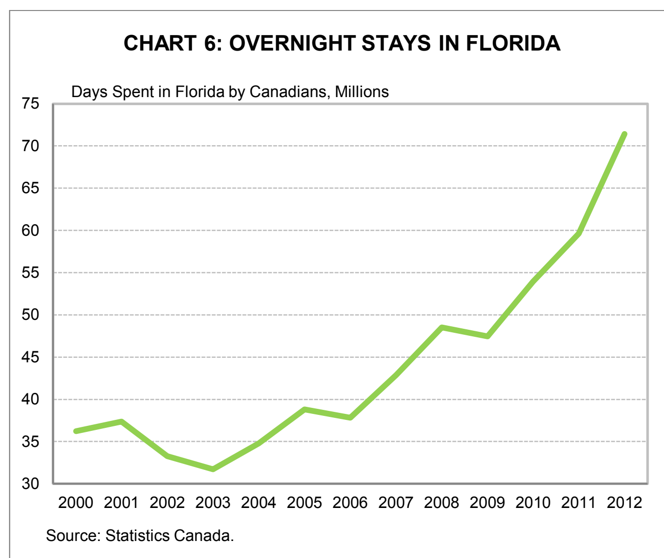
about $4.4 billion in Florida. Comparable figures for New York – the most visited state overall – were 4 million visits and spending of $1.6 billion. This large gap in money spent can be traced back to the higher number of nights spent in the Sunshine state. The average Canadian stay in Florida was 21 days versus 2.5 days in New York. Indeed, Florida comprises about one-fifth of all Canadian spending in the United States. Two other popular snowbird destinations are California and Arizona, where Canadians' annual spending is $1.5 billion and $0.9 billion, respectively.

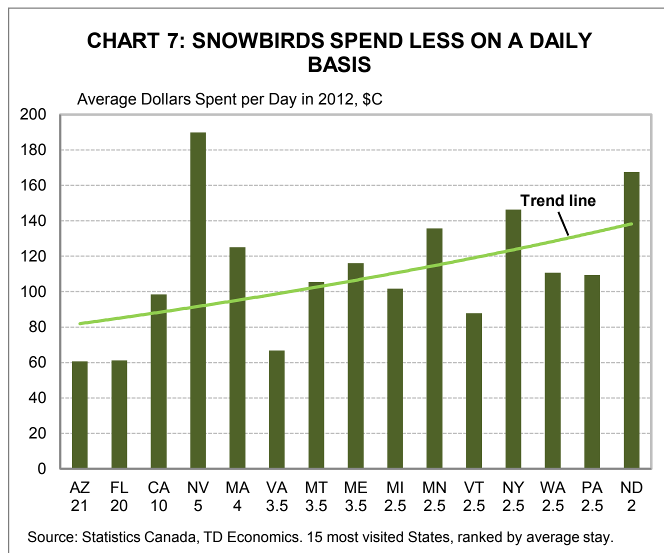
Relative to short-term stays, longer term stays are characterized by lower daily spending rates. Staying at rented or owned accommodation, snowbird daily housing and food costs tend to be lower. Chart 7 illustrates how spending per day is inversely related to average days spent. In analyzing impacts of the weaker currency, it is reasonable to expect that sensitivity to higher prices in Canadian dollar terms are lessened as average stays become longer. For example, an increase in daily spending in Florida from $60 to $66 may act more as an annoyance than a game changer. However, for a long-weekend family trip, a 10% increase may act as more of a deterrent. What's more, with flight prices increased in local currency (as air carriers have most of their expenses priced in U.S. dollars - most notably fuel costs), short vacations by airplane become a much larger burden that will disproportionately impact shorter trips relative to those made by snowbirds.

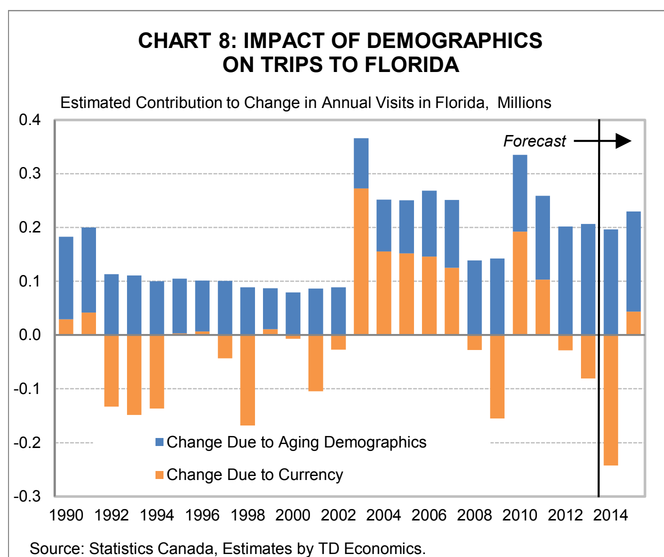
Make no mistake, the depreciation of the Canadian dollar will have an impact on Canadian stays in snowbird destinations such as Florida, but less than one might expect. The growing flock of snowbirds is based more on an aging population and on lifestyle choice, which will insulate this activity against swings in the Canadian dollar. We anticipate both spending and long-term visits to continue to grow over the next few years in the snowbird destinations, albeit at a slower rate than in recent years. Chart 9 shows the impact of the currency depreciation on visits in Florida, and a similar pattern is expected in states such as Arizona and California.

Canadians to remain major investors in U.S. real estate

Canadians will remain heavily tied to snowbird destinations through their substantial holdings of residential real estate. More than half a million Canadians now own properties in Florida as they accounted for roughly one third of all real estate bought by foreigners in recent years[2]. Much of this accumulation occurred during the past five years,





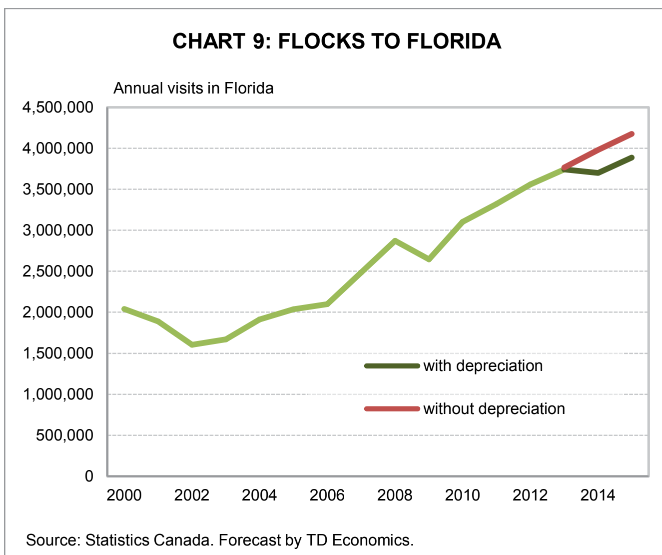


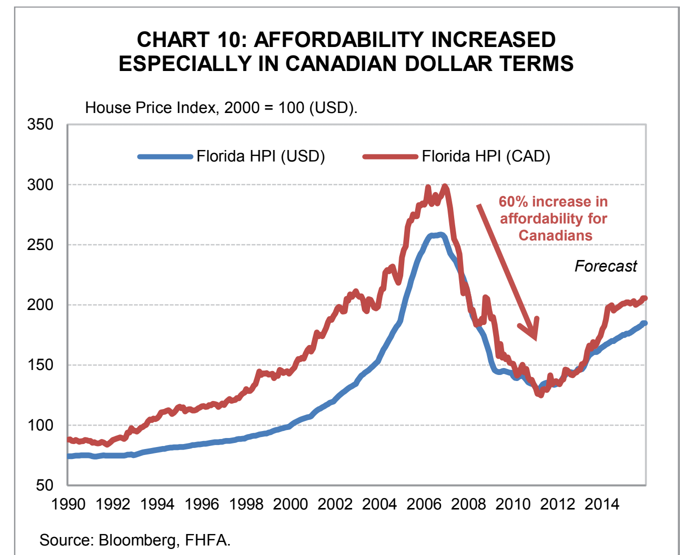
when the combination of a stronger Canadian dollar and tumbling U.S. home prices translated into a roughly 60% cheapening (from peak to bottom) in the average Florida home in own-currency terms. Indeed, during the lows of the housing crisis, it has been estimated that almost 10% of total purchases in Florida were by Canadians.

No matter how you slice it, new purchase activity by Canadians in the U.S. looks set to slow markedly over the next few years:

- As chart 10 shows, the rebound in U.S. home prices and the decline in the Canadian dollar has recently changed the economics of home buying for the worse.
- In addition to more expensive real estate, the cost of borrowing (as measured by U.S. 30-year mortgage rates) has increased by about 100 basis points over the past year. Still, this impact will be mitigated by the fact that many affluent Canadians purchase real estate with cash.
- Canadians tend to buy comparatively inexpensive houses that have become in short supply. More than half of purchased properties were worth less US$200,000, where inventories were down about 20% in 2013.
- Besides these factors, part of the slowdown in real estate purchases will also emanate from many recent purchases having been brought forward to take advantage of a bottoming housing market.

This is not to say that the flow of Canadians choosing the snowbird lifestyle will slow significantly. Indeed, we see flows continuing to grow both in the medium- and longer-term. Existing Canadian property owners in U.S. real estate will likely be inclined to hold on to their appreciating in-





vestments. And for those Canadians that rent out their units, the drop in the Canadian dollar has improved cash flow in Canadian-dollar terms. This impact will help to offset any negative effect of the declining Loonie on real estate purchases. Perhaps most importantly, even if Canadians choose to purchase real estate in smaller numbers, we see renting becoming an increasingly preferred option.

Bottom line

Putting it all together, the declining trend in the Canadian dollar will leave its mark on the number of Canadian visits to the United States, but primarily those that jump across the border to take advantage of lower U.S. prices on goods. On the plus side, Canadian retailers within close proximity to the border are likely to benefit by both Canadians staying closer to home and the prospects of increased U.S. traffic. In contrast to short-term visits, we do not expect to see a significant impact on longer-term stays in the United States. This conclusion reflects the fact that snowbird decisions are driven more by lifestyle choices than economic ones. What's more, the sizeable share of snowbirds that own U.S. real estate creates a powerful tie linking these individuals to their U.S. communities.

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End Notes

1. Ambarish Chandra, K. H. (2013). The Economics of Cross-Border Travel.

2. Lawrence Yun, P.B. (2013). Profile of International Home Buyers in Florida 2013 Report. National Association of REALTORS.

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