

# Canadian Trade Review

## A Quarterly Review of Canada's Trade Performance

Third Quarter 2002

***This trade and investment quarterly review reports on Canada's economic growth in the third quarter of 2002, and highlights our trade and investment performance in key sectors and markets.***

## Rebounding Exports Support Continued Economic Growth in the Third Quarter

The Canadian economy continued to expand in the third quarter of 2002, with real gross domestic product (GDP) increasing by 3.1% on an annualized basis.<sup>1</sup> Although still robust, this growth rate was down from 4.4% in the previous quarter. The United States, in contrast, registered 4.0% GDP growth in the third quarter, up from 1.3% during the previous quarter, thereby outperforming Canada for the quarter.

A rebound in exports coupled with a strong housing market supported Canadian economic growth in the third quarter, while consumer spending was flat and business capital spending slowed. Exports of goods and services increased by 10.8%, mainly due to a strong expansion of shipments to the U.S. (particularly of motor vehicles and parts); however, exports to the European Union (EU), in particular to the United Kingdom, slipped over the quarter. Canada's continued economic expansion also supported a broadly based 9.5% increase in imports. Export growth outpaced import expansion in the third quarter, reversing the situation registered in the previous quarter.

Job creation also continued to be strong in the third quarter, with a net quarterly increase of 123,100 jobs. An increase in the number of job seekers, however, pushed the average unemployment rate in the third quarter to 7.6% from 7.5% in the second quarter.

**Table 1: Canada's Economic and Trade Indicators**

Percent Change at Annual Rates Third Quarter 2002 over Second Quarter 2002	
Real GDP ( <i>annualized</i> )	3.1
Employment ( <i>quarterly increase, level</i> )	123,100
Rate of Unemployment ( <i>quarterly average</i> )	7.6
Consumer Price Index ( <i>third quarter 2002 over third quarter 2001</i> )	
All Items	2.3
Core ( <i>excludes food and energy</i> )	2.4
Canadian \$ in U.S. funds ( <i>quarterly average, level</i> )	0.6399
Exports of Goods and Services ( <i>annualized, current dollars</i> )	10.8
Imports of Goods and Services ( <i>annualized, current dollars</i> )	9.5

Source: Statistics Canada

The overall Consumer Price Index (CPI) increased by 2.3% compared with the same quarter a year earlier, up from a 1.3% increase in the second quarter of this year. The four-quarter increase in the CPI for core items (excluding food and energy) was 2.4%, up from the 2.2% recorded for the previous quarter. Thus, inflation—the rate of change in the CPI—is on the rise, yet remains within the Bank of Canada's target range of 1% to 3%. The Canadian dollar depreciated slightly vis-à-vis the U.S. dollar over the third quarter—from US\$0.6432 to US\$0.6399.

<sup>1</sup> To make quarterly data comparable to annual data, the quarterly figures for trade in goods and services are adjusted for seasonality and are expressed at annual rates by raising them four times, i.e. seasonally adjusted annual rates - s.a.a.r. All figures, with the exception of investment figures, are expressed on an s.a.a.r. basis, unless otherwise noted.

# Trade and Investment Highlights

## Exports Expand Faster than Imports in the Third Quarter

Exports of Canadian goods and services increased by 10.8% in the third quarter, with merchandise exports expanding by 12.0% (Figure 1). Imports of goods and services increased by 9.5%, with merchandise imports rising by 11.4%. However, imports of services declined from the previous quarter.

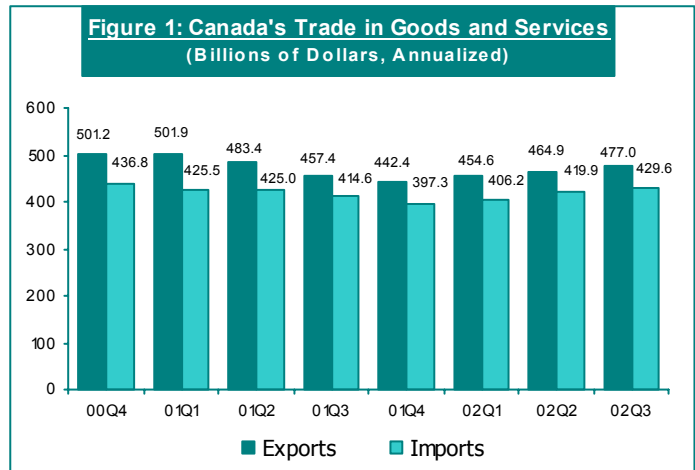
Merchandise exports expanded across all sectors, with the exception of forestry (Figure 2). Export growth was particularly strong for autos, consumer goods and energy. Similarly, the expansion of imports was evident for all commodities, and particularly strong for energy, agriculture and fishing, and autos. Merchandise exports expanded to all markets, with the exception of the EU, where shipments to the United Kingdom underwent a substantial decline. Export growth was especially strong to the U.S. and to non-OECD countries. Merchandise imports from all major markets expanded, with the exception of imports from the EU and Japan. Similar to the decline in exports to the U.K., a decline in imports from the U.K. contributed to the slump in imports from the EU as a whole. Imports from non-OECD countries recorded rapid growth at 36.4% over the quarter. As a result of exports expanding more rapidly than imports, the trade balance in the third quarter improved to \$47.4 billion from \$45.0 billion in the previous quarter. Regionally, a substantial improvement in the trade balance with the United States and small improvements in the trade balances with the EU and Japan were partly offset by declines in the trade balance with other markets.

## Services Trade Deficit Improves

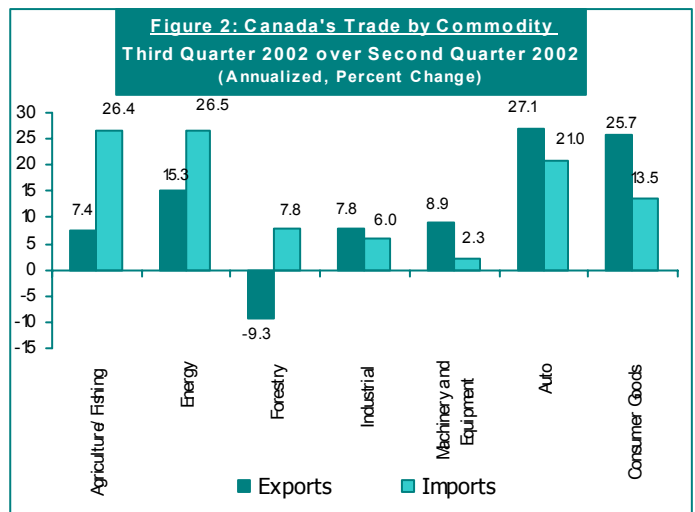
Services exports increased by 2.5% in the third quarter—led by transport and travel services, while commercial services exports declined. Overall services imports recorded a 0.3% decline during the quarter—as growth in imports of transport services (20.7%) and travel (2.9%) was insufficient to offset the 10.1% decline in commercial services imports. As a result, the services trade deficit fell by \$400 million to \$8.6 billion. For details by type of services, see Figure 3.

## Both Inward and Outward Foreign Direct Investment Decline

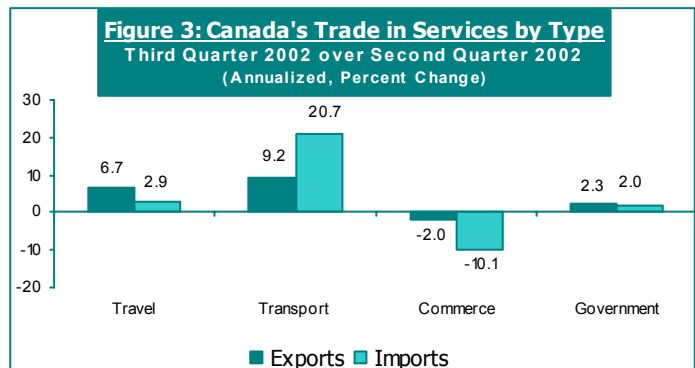
The third quarter of 2002 recorded \$1.57 billion in inward foreign direct investment (FDI) flows, just over a fifth of the \$7.27 billion in FDI recorded in the same quarter in 2001. The drop in FDI was caused by disinvestment by the U.S., particularly in the energy sector, though this was partially offset by increased inflows from the EU and other major areas. Outward Canadian direct investment abroad (CDIA) flows, however, were maintained at \$12.8 billion in the third quarter—comparable with the level in the same quarter one year earlier. Nevertheless, the destination of CDIA has changed over the last year; there was a steep decline in CDIA to the U.S. in favour of all other major areas, with the exception of Japan.



Source: Statistics Canada



Source: Statistics Canada



Source: Statistics Canada

## Canada Draws Down on Its Official International Reserves

Canada reduced its official reserves of assets in the third quarter of 2002 by \$1.9 billion, compared with a smaller \$130 million reduction recorded in the same quarter in 2001.

## EVOLUTION OF CANADA'S MERCHANDISE TRADE, 1988-2001

This special feature provides a broad outline of the pattern of Canadian merchandise trade over the period from 1988, when the harmonized system for commodity classification was introduced, to 2001, the last year for which full data are available. Particular emphasis is given to Canada-U.S. trade.

### Overview

Over the period 1988-2001, Canadian merchandise exports expanded at an average annual rate of 8.5%, from \$138 billion to \$402 billion.<sup>1</sup> Over the same period, merchandise imports increased from \$131 billion to \$343 billion, an average annual growth rate of 7.7%. As a result of the more rapid growth in exports than imports, Canada widened its overall merchandise trade surplus from \$7 billion in 1988 to \$59 billion in 2001. Gains were especially notable with respect to the United States: the U.S. share of Canadian merchandise exports increased by 14.4 percentage points to 87.2% over the period (Table 2).

The offsetting share declines were evenly spread out, with drops of over 4 percentage points each for the EU, for Japan, and for all other non-OECD countries. On the other hand, the U.S. share of Canadian merchandise imports fell to 63.6% in 2001 from 65.6% in 1988. Canadian import shares for the EU and Japan also declined over this period, to the benefit of the other OECD countries and the other non-OECD countries.

Commodity-wise, Canada deepened its exports of its three dominant commodities—motor vehicles, mineral fuels and machinery—over the 1988-2001 period, possibly signalling a trend toward increased specialization in these areas. These three commodities accounted for 43.2% of total Canadian merchandise exports last year, up from 40.8% in 1988 (Table 3). However, widening the picture to the 10 or 20

**Table 3: Commodity Concentration in Canada's Trade with Major Trading Partners**

	Total Exports (%)					
	Top 3 Commodities		Top 10 Commodities		Top 20 Commodities	
	1988	2001	1988	2001	1988	2001
World	40.8	43.2	69.1	68.1	84.0	79.5
United States	50.8	46.8	75.6	71.6	88.2	81.1
EU-15	33.5	36.6	61.7	67.7	80.9	84.6
Japan	41.0	41.3	82.1	77.5	91.5	92.3
Other OECD	20.9	31.7	56.7	66.1	79.8	83.5
Non-OECD	42.7	34.7	71.2	65.8	84.4	83.0

	Total Imports (%)					
	Top 3 Commodities		Top 10 Commodities		Top 20 Commodities	
	1988	2001	1988	2001	1988	2001
World	51.2	47.0	68.5	67.6	79.9	79.8
United States	57.7	50.0	73.2	69.1	85.0	82.6
EU-15	39.4	40.9	66.2	74.3	79.7	84.8
Japan	76.3	75.6	90.7	93.2	96.3	97.3
Other OECD	35.1	53.1	59.4	79.6	76.5	88.9
Non-OECD	27.3	41.6	55.2	65.9	74.4	82.0

Source: Statistics Canada

largest export commodities, their share in total goods exports fell over 1988-2001, suggesting that Canadian producers have been diversifying their export sales.

With respect to the U.S., the trend toward diversification holds: the share of the top three, top 10 and top 20 merchandise exports to the U.S. all fell between 1988 and 2001. But for the EU, the opposite is true: the top products all expanded their export share during the period, suggesting increasing concentration in Canadian exports to the EU through time. The pattern for Japan is interesting: the top three Canadian exports maintained their share over

time, the share for the next seven largest exports declined, while the 11th through 20th largest export commodities to Japan increased their share.

The three largest Canadian imports (machinery, motor vehicles, and electrical machinery and electronics) saw their share of all Canadian imports slip from just over one-half of merchandise imports in 1988 to just under the halfway mark (47.0%) in 2001. The seven next largest products managed to capture most of the share lost by the top three, as the top 10 import commodities more or less managed to maintain their share.

As was the case for merchandise exports, the share of the top three, top 10 and top 20 merchandise imports from the U.S. fell over 1988-2001 but increased for imports from the EU. For Japan, the import share of the top three commodities edged down slightly, but the share of the top 10 and top 20 import commodities was up.

**Table 2: Canadian Total Merchandise Trade by Major Trading Partners**

	Total Exports (%)		Total Imports (%)	
	1988	2001	1988	2001
United States	72.8	87.2	65.6	63.6
EU-15	8.6	4.5	13.4	11.2
Japan	6.4	2.0	7.1	4.3
Other OECD	3.0	1.9	4.6	7.2
Non-OECD	9.2	4.3	9.4	13.7
World	100.0	100.0	100.0	100.0

Source: Statistics Canada

1 Trade figures reflect merchandise exports and imports in current Canadian dollars, on a customs basis.

## Trade with U.S. Regions

As the destination of over 87% of Canadian merchandise exports and the source of two-thirds of Canadian goods imports, the United States and its various regions merit special attention.

Subdividing the United States into four regions (the South, West, Midwest and Northeast), along the lines of the U.S. Bureau of Economic Analysis groupings, allows for a more focused examination of trade trends. Canadian exports to the U.S. expanded by an average of 10.1% *per annum* from 1988 to 2001. Although exports to all four regions expanded in this period, exports to the West and the South grew faster than the overall pace and, consequently, captured increasing shares. At the same time, the Northeast and Midwest experienced declines in their relative importance as a destination for Canadian exports (Table 4). Despite its relative decline in importance, the Midwest remains the most important destination for Canadian exports to the U.S., accounting for 41.0% of overall exports to that country in 2001.

With respect to Canadian imports from the United States, imports from the West expanded at a level commensurate with overall Canadian import growth and therefore maintained their share (about 11%) between 1988 and 2001. On the other hand, imports from the U.S. Northeast and U.S. Midwest grew at a slower rate than the overall Canadian average and therefore declined in relative importance. It was Canadian imports from the U.S. South that expanded their share of total Canadian imports over this period. Again, as was the case for exports, although the share of imports from the Midwest declined from 47.7% in 1988, it still accounted for 43.1% of imports in 2001.

The dominant role that the U.S. Midwest plays in Canadian trade is largely attributable to the importance of motor vehicle trade with this region (Table 5). Motor vehicles are neck and neck with machinery as the largest traded commodity between Canada and the United States. However, whereas trade in machinery is more evenly distributed across the four U.S. regions (although still favouring the Midwest), Canada-U.S. motor vehicle trade is highly skewed in favour of the Midwest. Buttressing this dominance is the fact that the largest

**Table 4: Distribution of Canadian Trade with United States Regions, 1988 and 2001**

	Exports (% share)		Imports (% share)	
	1988	2001	1988	2001
Northeast	30.8	23.2	21.9	18.5
Midwest	45.6	41.0	47.7	43.1
South	12.6	16.8	17.2	25.4
West	10.7	17.2	10.7	11.2
Other U.S. territories	0.3	1.8	2.5	1.8
Total	100.0	100.0	100.0	100.0

Source: Statistics Canada

share of Canadian exports of mineral fuels (the second largest of Canada's three principal export commodities to the U.S.) is also shipped to the Midwest.

The importance of the U.S. South for both Canadian exports and imports has been rising in recent years. This region has become increasingly significant as a recipient of Canadian exports of mineral fuels and machinery. From 1988 to 2001, the share of Canadian mineral fuels exports to this region rose from 3.5% to 10.0%, while the share of machinery exports climbed from 20.4% to 26.0%. Motor vehicle exports to the region accounted for about 4.6% in both 1988 and 2001.

The U.S. South has also become an increasingly important source for all three of Canada's top import commodities. Between 1988 and 2001, the South increased its share of Canadian imports of motor vehicles from 10.2% to 18.7%. Meanwhile, its share of machinery imports rose from 15.7% to 23.2%, and its share of electrical machinery and electronics imports jumped from 23.3% to 33.8%.

The U.S. West also became more important for both Canadian imports and exports over 1988-2001. In fact, the region's share of Canadian exports surpassed the share accounted for by the

U.S. South in 2001. The region became increasingly important as a destination for Canadian exports of motor vehicles and machinery: from 1988 to 2001, its share of Canadian exports of motor vehicles increased from 3.1% to 15.1%, and its share of shipments of machinery rose from 8.6% to 16.0%. The region is the destination for about one-quarter of all mineral fuels exports to the United States. As a source for Canadian imports from the U.S., the West saw only marginal changes in its share of motor vehicle and machinery imports, while its share of electrical machinery and electronics imports increased from 11.3% to 16.9%.

Lastly, although the Northeast still accounts for almost one-quarter of Canada's exports to the U.S. and almost one-fifth of imports from the U.S., it has become less important on the Canadian trade radar screen. The share of Canadian exports of mineral fuels and machinery to the U.S. Northeast saw modest declines from 1988 to 2001, while the region's share of Canadian motor vehicle exports fell from 22.2% to 6.6%. On the imports side, the Northeast saw its share of all three of Canada's major import commodities decline during the period—from 11.3% to 5.3% for motor vehicles, from 19.2% to 15.4% for machinery, and from 33.0% to 23.4% for electrical machinery and electronics.

**Table 5: Canada's Top Three Import and Export Commodities in United States Trade**

Canadian Exports to the United States as per cent share, 2001						
Rank	Commodity	Northeast	Midwest	South	West	
1	Motor vehicles	6.6	73.7	4.6	15.1	
2	Mineral fuels	25.8	37.6	10.0	26.6	
3	Machinery	18.6	39.4	26.0	16.0	
Canadian Imports from the United States as per cent share, 2001						
Rank	Commodity	Northeast	Midwest	South	West	
1	Motor vehicles	5.3	73.1	18.7	2.9	
2	Machinery	15.4	50.3	23.2	10.8	
3	Electrical Machinery/Electronics	23.4	25.3	33.8	16.9	

Source: Statistics Canada