S U P P L E M E N T

CanadExport

Canadian Trade Review

A Quarterly Review of Canada's Trade Performance

Third Quarter 2001

This trade and investment quarterly reports on Canada's economic growth in the third quarter of 2001, and highlights our trade and

Continued Weak Canadian Exports Accompanied by Slowdown in Imports in the Third Quarter of 2001

In the third quarter, the decline in the U.S. economy, combined with the sluggishness in the economic performance in Europe, Asia and Latin America, contributed to a decline in the international demand for Canadian goods and services.

Canada's current dollar exports of goods and services declined by 21.4% (s.a.a.r[1]) in the third quarter of 2001—a continuation of the contraction in exports initiated in the previous quarter after four years of unbroken export growth.

In contrast to the situation in the second quarter, imports also experienced a decline in the third quarter. Taken together, imports of goods and services declined by 10.3% in the July to September third quarter.

Table 1: Canada's Economic and Trade Indicators

Percent Change at Annual Rates Third Quarter 2001 over Second Quarter 2001	
Real GDP	-0.8
Employment (*quarterly increase, level*)	12,300
Rate of Unemployment (*third quarter average in percent*)	7.1
Consumer Price Index (*third quarter 2001 over third quarter 2000 percent change*)	
All Items	2.7
Core (*excludes food and energy*)	2.3
Canadian $ in U.S. funds (*third quarter average*)	0.6468
Exports of Goods and Services (*based on current dollars*)	-21.4
Imports of Goods and Services (*based on current dollars*)	-10.3

Source: Statistics Canada

Canada's real gross domestic product (GDP) declined by 0.8% in the third quarter. The deterioration in the performance of the foreign trade sector accounted for 0.3 percentage points of this 0.8% decline in real GDP. Despite the overall real GDP decline, business investments increased during the quarter—led by added investments in machinery and equipment.

Job creation slowed during the quarter—a net increase of 12,300 jobs was reported, down from 40,000 in the second quarter and 34,000 in the first quarter. The average unemployment rate edged up to 7.1% from 7.0% in the previous quarter—slightly above the 26-year low of 6.8% experienced in 2000.

Overall, inflation in the third quarter was 2.7%, down from 3.5% in the second quarter, and core inflation (excluding food and energy) remained unchanged from the previous quarter at 2.3%. Thus, inflation remains within the target range of 1% to 3% that has been established by the Bank of Canada.

The average U.S. dollar value in the third quarter was C$0.647—a slight decline from C$0.649 in the previous quarter.

1 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 a s.a.a.r basis, unless otherwise noted.

Prepared by the Trade and Economic Analysis Division (EET)

Department of Foreign Affairs and International Trade

Ministère des Affaires étrangères et du Commerce international

Canada

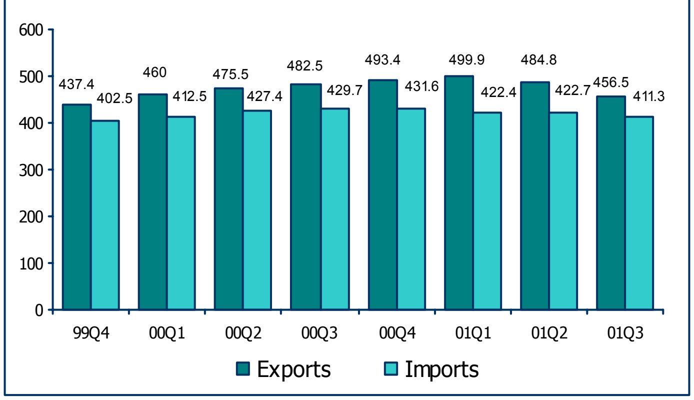
Trade and Investment Highlights

The broader-based current account surplus for the third quarter was $22.1 billion—down from $36.0 billion in the second quarter. The nine months' surplus this year still exceeds the record high of $26.9 billion for 2000 as a whole. The drop in the current account surplus in the third quarter can be explained by a substantial decline in the merchandise trade surplus (down $16.7 billion), a marginal increase in the persistent services trade deficit (increased by $328 million) and a small increase in the portfolio investment income deficit (increased $254 million). On the other hand, a reduction in the deficit for income generated from direct investments contributed to improve the current account balance by $3.1 billion.

Both inward and outward direct investments declined in the third quarter. Outward direct investment flows declined by 18.8% from the previous quarter, whereas inward direct investment flows declined by 37.5%. Outward direct investment exceeded inward direct investment by $6.3 billion in the third quarter, up from $4.7 billion in the second quarter.

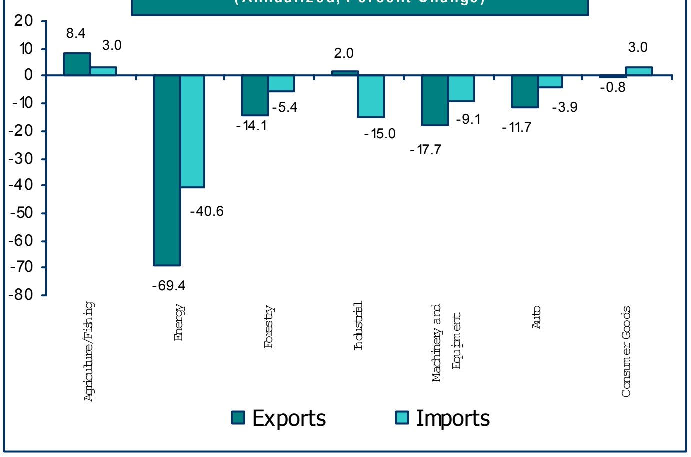
On the portfolio side, outward investments saw a dramatic decline in the third quarter, led by a 70.9% drop in Canadian purchases of foreign stock, but were somewhat offset by a more limited increase in Canadian purchases of foreign bonds. For inward portfolio investments, foreign purchases of Canadian stocks and bonds declined, but were more than offset by increases in foreign-held loans and deposits in Canada.

Figure 1: Canada's Trade in Goods and Services
(Billions of Dollars, Annualized)



Source: Statistics Canada

Figure 2: Canada's Trade by Commodity
Third Quarter 2001 over Second Quarter 2001
(Annualized, Percent Change)



Source: Statistics Canada

The Slowdown in U.S. and Other Economies Limited Canada's Exports

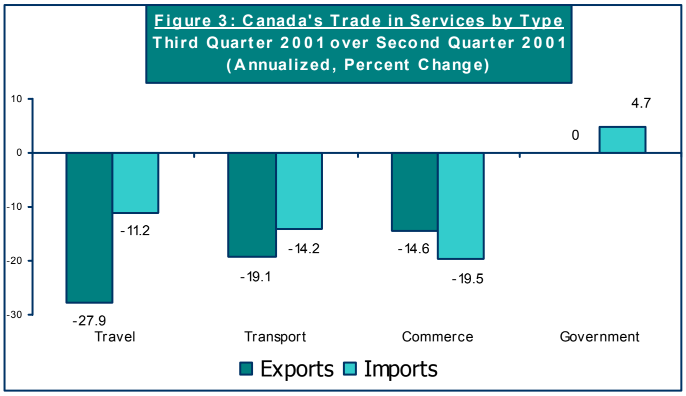
Exports of goods and services declined to $456.5 billion in the third quarter from $484.8 billion in the second quarter. Merchandise exports totalled $403.0 billion in the third quarter compared to $428.4 billion in the previous quarter—down 21.7%.

The largest decline in exports was experienced by energy exports (down 69.4%), but machinery and equipment, forestry products and automotives also experienced declines. Exports to all countries declined. Exports to the United States fell by 21%, while exports to all other countries, with the exception of exports to the United Kingdom (down 4.4%) and Japan (down 20.0%), experienced larger rates of declines.

Imports also decreased in the third quarter, in contrast to the modest increase recorded in the second quarter. Imports of goods and services declined from $422.7 billion in the second quarter to $411.3 billion in the third quarter. Similarly, merchandise imports fell from $360.5 billion in the second quarter to $351.8 billion in the third quarter.

Although imports of services declined at a faster pace than merchandise imports, the largest decline in merchandise imports occurred in imports of energy (down 40.6%) and industrial goods. Although imports from the United States and the United Kingdom declined in the third quarter, imports from Japan and European Union (EU) countries other than the United Kingdom increased in the third quarter.

The merchandise trade surplus declined from $67.9 billion in the second quarter to $51.2 billion, led by a steep decline in the merchandise trade balance in energy products. As most of the Canadian exports in energy products are destined for the United States, the merchandise trade balance with the United States experienced a severe decline over the previous quarter. However, the merchandise trade balance with all major trading partners deteriorated in the third quarter, with the exception of the United Kingdom.



Source: Statistics Canada

Services Trade Deficit Reverses Its Previous Decline

In the third quarter, Canada's services exports declined to $53.5 billion compared to $56.4 billion in the second quarter, while services imports declined to $59.5 billion from $62.1 billion in the previous quarter. The more rapid decline in services exports than services imports led to an increase in the services trade deficit of $328 million.

Canada's international travel deficit worsened in the July to September quarter after reaching the lowest deficit recorded since the third quarter of 1986 in the previous quarter. The increase in the deficit was primarily a result of a sharp drop in the spending in Canada by foreign visitors (down 28.0% over the previous quarter), which overshadowed a more modest decline in Canadian travel expenditures abroad (down 11.2%). On the other hand, Canadian travel expenditures in the United States declined at a faster rate than the decline in U.S. travel expenditures in Canada. This led to a further decline in the travel deficit with the United States, which reached its lowest level in more than 10 years.

Trade in commercial services, which account for about half of all imports and exports of services, experienced declines in both exports and imports in the third quarter. However, as the decline was larger in imports than in exports, the commercial services trade deficit fell by $500 million.

Inward and Outward Foreign Direct Investment Declined

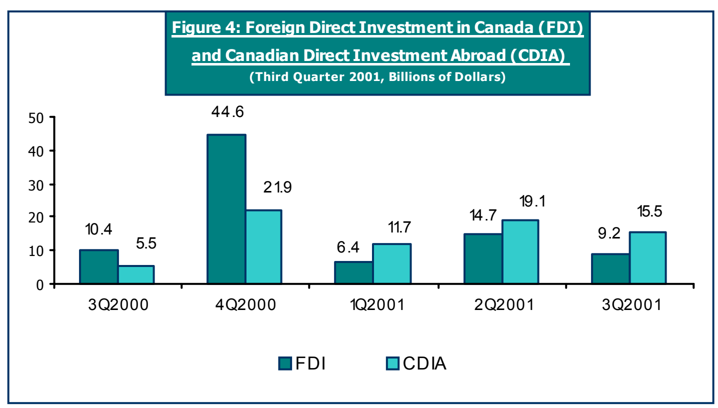
Both inward and outward direct investment flows declined in the third quarter from the second quarter. Outward flows in the form of Canadian direct investment abroad (CDIA) declined from $19.1 billion in the second quarter to $15.5 billion in the third quarter, and inflows of foreign direct investment (FDI) similarly declined from $14.7 billion to $9.2 billion in the same period.

For CDIA, the wood and paper sector experienced an almost tenfold increase in the third quarter from the second quarter. On the other hand, CDIA declined in both the machinery and transport sector, and the finance and insurance sector. CDIA in the energy sector, which surged in the second quarter, eased off in the third quarter. The decline in CDIA occurred predominantly in the investment that was directed to countries that are not members of the Organization for Economic Co-operation and Development and to EU countries other than the United Kingdom.

FDI experienced a dramatic drop in the other industries sector—down $5.6 billion (or 80%) in the third quarter from the second quarter. Although FDI in the machinery and transport sector was also down in the third quarter, this was offset by increases in the wood and paper, and energy sectors. FDI from the United States registered an increase in the third quarter over the second quarter, but this was more than offset by a large decline in FDI from the United Kingdom and by escalating disinvestments from the EU countries other than the United Kingdom.

As mentioned, the sharp reduction in Canadian purchases of foreign stocks in the third quarter over the second quarter was the main contributing factor to the decline in the flow of portfolio investments abroad from a rate of $12.3 billion in the second quarter to $5.0 billion in the third quarter. The sharp decline in the flow of Canadian equity investments abroad overshadowed a $1.5-billion increase in Canadian purchases of foreign bonds in the third quarter compared to the second quarter.

Similarly, the flow of foreign portfolio investments in Canada also declined in the third quarter from the second quarter—a combination of declining purchases of Canadian bonds and disinvestments in Canadian stocks among foreign investors.



Source: Statistics Canada

Canada's Official International Reserves Record a Marginal Decline

Canada's official reserve assets were reduced by a marginal $130 million in the third quarter—comparable to the decline in the second quarter. This reversed a trend of substantial additions to the reserves in the prior three quarters.

Features Section

Canada and Mexico Trade with the United States

Introduction

In the last decade, Canadian and Mexican exports to the United States have risen sharply. Although Canada still ranks as the premier source of imports into the United States, the more rapid recent growth in U.S. imports from Mexico has prompted speculation that Mexico would surpass Japan and subsequently Canada to take the lead as the major source of imports into the United States. The following analysis intends to review the structure and category composition of Mexican exports to the United States to examine the basis for, and validity of, the above referenced prediction.

Background

Canada has maintained its ranking as the most important source of imports into the United States over the last decade, notwithstanding increases in U.S. imports from a number of other countries. In the 1990s, Canada's share of total U.S. merchandise imports increased from 18.7% in 1990 to 19.6% in 1994, levelling off to 19.1% in 2000. Japan—the 2nd largest source of U.S. imports—has seen its share decline from 18.1% in 1990 to 12.0% in 2000, while Mexico—ranked 3rd—has expanded its share from 6.1% in 1990 to 7.5% in 1994 and further to 11.2% in 2000. Over the last decade, China has also increased in importance as a source for U.S. imports. In 1990, China accounted for 3.1% of U.S. imports and ranked as the 8th largest source country, but moved up to rank as the 4th largest source country and to account for 8.2% of U.S. imports in 2000.

With respect to both Mexico and Canada, two parallel developments have enhanced the role of their exports to the United States:

1. An increasing share of overall exports destined for the United States, obviously stimulated by the Free Trade Agreement (FTA) (in effect since 1989 between Canada and the United States) and the North America Free Trade Agreement (NAFTA) (in effect among Canada, United States and Mexico since 1994). For Canada, the combined share of goods (merchandise) and services exports destined for the United States has increased from 71.2% in 1990 to 81.9% in 2000, while, for Mexico, the share has grown from 76.4% in 1990 to 82.1% in 2000.

2. Exports represent a growing share of gross domestic product (GDP) in both Canada and Mexico.

The combined effect of these two developments has expanded the share of GDP represented by exports of goods and services to the United States in both Canada and Mexico. In Canada, this share increased from 17.9% in 1990 to 36.3% in 2000, and, in Mexico, the share expanded from 14.2% in 1990 to 25.8% in 2000. For Mexico, most of the expansion of this share has taken place in the 1994-2000 period, i.e. following Mexico's entry into the NAFTA.

Category Composition of U.S. Imports from Mexico

Our analysis of Mexico's penetration of the U.S. import market over the last decade—and the comparison with Canada's exports to the United States—is based on a review of the top 25 Mexican export categories shipped to the United States in 2000 (See Table 1.). Such a focus will of course lead to a positive bias in Mexico's favour. However, this bias is minimized by an overlap in the Canadian and Mexican category composition for their major exports to the United States—among the top 10 Mexican products in 2000, seven of the categories are also ranked among the top 10 Canadian U.S. export products[1]. Among the top 20 Mexican U.S. export products in 2000, 14 can also be found among the top 20 Canadian products.

Since 1990, most of Mexico's top 25 export categories to the United States, as measured by U.S. import data, have expanded rapidly. The three top categories of Mexican exports to the United States in the 1990-2000 period are **electrical machinery and electronics**, **motor vehicles** and **machinery and engines**. The dominance of these three categories has increased over time. Taken together, they accounted for 45.7% of Mexican exports to the United States in 1990, 54.4% in 1994 and 57.9% in 2000. Similarly, the top 25 categories also accounted for an increasing share of Mexican shipments over time. They accounted for 84.7% of Mexican exports to the United States in 1990, 87.7% in 1994 and 90.3% in 2000. The largest increase in the share of total Mexican exports to the United

1 Missing from the top 10 Mexican export products to the United States in 2000 are the corresponding top 10 Canadian exports to the United States: **wood and wood products** (ranked as the 5th largest Canadian U.S. export product in 2000); **aircrafts** (ranked 9th); and **aluminium** (ranked 10th).

States is accounted for by **motor vehicles**. Its share increased by a total of 7 percentage points in the 1990-2000 period, of which 4.7 points were added under the NAFTA since 1994. The share of **machinery and engines** increased by 4.6 percentage points from 1990 to 2000, led by an increase of 3.0 percentage points in the 1990-1994 period. On the other hand, the share accounted for by **mineral oils and fuels** decreased by 8.1 percentage points, led by a decline of 7.2 percentage points in the 1990-1994 period.

Mexico's Market Penetration into the United States

Among Mexico's top 10 export categories, **edible vegetables** accounted for the largest U.S. import market share (for the individual category) at 59.8% in 2000, although this market share had declined from 68.4% in 1990. Seven of the top 10 categories increased their market share in the United States with more than five percentage points in the 1990-2000 period. Increased U.S. import market penetration by Mexican shipments under the NAFTA have been particularly notable for **knitted and crocheted clothing**, where market penetration increased by 9.1 percentage points, **motor vehicles** (up 8.5 percentage points), **machinery and engines** (up 4.3 percentage points) and **electrical machinery and electronics** (up 4.0 percentage points).

Table 1: Major Categories Exported by Mexico to the United States

Category (HS Chapter) - Listed According to Year 2000 Mexico Ranking	1990			1994			2000		
	Category Ranking in Mexican Exports to United States	Category's Share of Total Mexican Exports to United States	Mexico's Share of Total U.S. Import of Category	Category Ranking in Mexican Exports to United States	Category's Share of Total Mexican Exports to United States	Mexico's Share of Total U.S. Import of Category	Category Ranking in Mexican Exports to United States	Category's Share of Total Mexican Exports to United States	Mexico's Share of Total U.S. Import of Category
HS-85 - Electrical Machinery, Electronics	1	25.7%	13.3%	1	29.1%	15.2%	1	26.3%	19.2%
HS 87 - Motor Vehicles, Motorcycles	3	12.1%	4.9%	2	14.4%	7.4%	2	19.1%	15.9%
HS-84 - Machinery and Engines	4	7.9%	3.6%	3	10.9%	5.1%	3	12.5%	9.4%
HS 27 - Mineral Oils and Fuels	2	17.5%	8.2%	4	10.3%	9.0%	4	9.4%	9.6%
HS 62 - Woven Clothing	8	1.8%	3.9%	7	2.6%	6.0%	5	3.8%	15.6%
HS 90 - Optical, Medical Instrumentation	6	2.2%	5.0%	5	3.7%	9.4%	6	3.3%	12.1%
HS-94 - Furniture and Lamps/Fixtures	7	2.2%	10.3%	6	2.6%	13.4%	7	2.8%	16.0%
HS 61 - Knitted and Crocheted Clothing	37	0.3%	1.0%	11	1.0%	4.2%	8	2.6%	13.3%
HS 73 - Articles of Iron or Steel	12	1.0%	4.6%	9	1.2%	7.5%	9	1.2%	11.2%
HS 07 - Edible Vegetables; Roots/Tubers	5	3.1%	68.4%	8	2.0%	65.1%	10	1.2%	59.8%
HS 22 - Beverages, Spirits and Vinegar	16	0.8%	6.4%	17	0.7%	7.4%	11	0.9%	15.3%
HS 39 - Plastics and Articles Thereof	19	0.8%	3.4%	12	1.0%	4.7%	12	0.9%	6.2%
HS 72 - Iron and Steel	14	0.9%	3.5%	10	1.2%	4.7%	13	0.8%	7.3%
HS 83 - Misc. Articles of Base Metal	29	0.5%	9.2%	25	0.5%	10.3%	14	0.6%	17.1%
HS 70 - Glass and Glassware	21	0.8%	13.2%	15	0.8%	14.2%	15	0.6%	18.2%
HS 08 - Edible Fruits and Nuts	11	1.1%	14.3%	14	0.9%	16.8%	16	0.5%	18.6%
HS 63 - Other Made-up Textile Articles	30	0.5%	11.8%	24	0.5%	12.7%	17	0.5%	14.9%
HS 95 - Toys, Games, Sporting Goods	17	0.8%	2.9%	13	0.9%	4.2%	18	0.5%	3.5%
HS 74 - Copper and Articles Thereof	23	0.7%	8.5%	20	0.6%	10.4%	19	0.5%	12.8%
HS 40 - Rubber and Articles Thereof	32	0.4%	2.3%	29	0.4%	2.7%	20	0.4%	5.8%
HS 86 - Rail Transportation, Tramways	72	0.0%	1.0%	44	0.1%	6.1%	21	0.4%	29.4%
HS 48 - Paper, Paperboard	25	0.6%	2.3%	32	0.3%	1.8%	22	0.4%	3.3%
HS 71 - Pearls, Precious Stones, Jewellery	13	0.9%	2.4%	22	0.6%	2.0%	23	0.4%	1.7%
HS 03 - Fish, Crustaceans, Molluscs	18	0.8%	5.5%	19	0.6%	5.6%	24	0.4%	6.2%
HS 09 - Coffee, Tea, Maté and Spices	10	1.2%	16.1%	18	0.7%	11.9%	25	0.3%	14.5%
Subtotal		84.7%			87.7%			90.3%	

Comparison between Mexican and Canadian Penetration of the U.S. Import Market

The ratio between the Canadian market share of U.S. imports of a particular category and the equivalent Mexican market share (the MSR) is used here as an analytical tool to review the evolution of the Canadian market share in U.S. imports in relation to the equivalent Mexican market share. An MSR exceeding one indicates an absolute market share advantage for Canada over Mexico, and a ratio below one indicates an absolute Mexican market share advantage over Canada.

The results of the MSR analysis on a category-by-category basis is mixed.

In general, although Mexico has made progress in diminishing the scope of the absolute advantage that Canada enjoyed in most of the major categories in 1990 (with the exception of **electrical machinery and electronics**), the expansion of Mexico's market shares for these categories in the 1990-2000 period has not altered the fact that Canada still maintained an absolute market share advantage in 2000.

Table 2: Changes in the Canadian over Mexican Market Share Ratio (MSR) by Categories

Reduction in the Canadian to Mexican Market Share Ratio (MSR) between 1990 and 2000

	Commodity	Mexican Rank 2000	Canadian Rank 2000	Market Share Ratio 1990	Market Share Ratio 2000	% Change in MSR 1994-2000	% Change in MSR 1990-2000
Canadian Absolute Market Share Advantage in 1990	HS 87 - Motor Vehicles, Motorcycles	2	1	7.19	2.15	-59.3%	-70.0%
	HS-84 - Machinery and Engines	3	3	3.16	1.10	-48.1%	-65.1%
	HS 90 - Optical, Medical Instrumentation	6	13	1.00	0.65	7.1%	-35.0%
	HS-94 - Furniture and Lamps/Fixtures	7	8	1.95	1.39	-15.7%	-28.7%
	HS 73 - Articles of Iron or Steel	9	11	4.15	2.20	-27.6%	-47.2%
	HS 22 - Beverages, Spirits and Vinegar	11	25	2.21	0.70	-64.2%	-68.4%
	HS 39 - Plastics and Articles Thereof	12	7	6.38	5.63	-5.1%	-11.8%
	HS 72 - Iron and Steel	13	16	4.67	2.07	-43.4%	-55.8%
	HS 83 - Misc. Articles of Base Metal	14	28	1.26	1.10	-21.6%	-13.3%
	HS 70 - Glass and Glassware	15	33	1.14	0.88	-28.7%	-23.0%
	HS 74 - Copper and Articles Thereof	19	21	3.72	1.86	-42.5%	-50.1%
	HS 40 - Rubber and Articles Thereof	20	15	9.00	4.02	-52.0%	-55.3%
	HS 86 - Rail Transportation, Tramways	21	31	71.26	1.52	-86.4%	-97.9%
	HS 48 - Paper, Paperboard	22	6	32.74	19.86	-50.2%	-39.3%
	HS 03 - Fish, Crustaceans, Molluscs	24	19	4.60	3.23	-0.7%	-30.4%
Mexican Absolute Market Share Advantage in 1990	HS-85 - Electrical Machinery, Electronics	1	4	0.59	0.47	17.9%	-19.9%
	HS 62 - Woven Clothing	5	29	0.19	0.17	-40.7%	-12.1%
	HS 61 - Knitted or Crocheted Clothing	8	26	0.76	0.25	-43.5%	-66.8%
	HS 08 - Edible Fruits and Nuts	16	67	0.18	0.16	-3.7%	-14.5%
	HS 63 - Other Made-up Textile Articles	17	64	0.21	0.21	6.5%	-0.2%

Increase in the Canadian to Mexican Market Share Ratio (MSR) between 1990 and 2000

	Commodity	Mexican Rank 2000	Canadian Rank 2000	Market Share Ratio 1990	Market Share Ratio 2000	% Change in MSR 1994-2000	% Change in MSR 1990-2000
Canadian Absolute Market Share Advantage in 1990	HS 27 - Mineral Fuels and Oils	4	2	1.87	2.46	-0.2%	32.1%
	HS 71 - Pearls, Precious Stones, Jewellery	23	12	2.76	5.90	-6.0%	113.9%
Mexican Absolute Market Share Advantage in 1990	HS 07 - Edible Vegetables; Roots/Tubers	10	40	0.16	0.32	83.0%	99.4%
	HS 95 - Toys, Games, Sporting Goods	18	35	0.59	0.92	23.5%	57.7%
	HS 09 - Coffee, Tea, Maté and Spices	25	73	0.03	0.20	332.4%	653.2%

In addition, Canada increased its absolute market share advantage in the **mineral oils and fuels** over this period. On the other hand, in the 1990–2000 period, Mexico has strengthened the absolute market share advantage it initially enjoyed in a number of categories—such as **electrical machinery and electronics**, **textiles** and **clothing**. **Electrical machinery and electronics** is ranked as the 4th most important category in Canadian exports to the United States, whereas **textiles** and **clothing** are of lesser significance and are not included among Canada's top 25 export categories.

Table 2 presents a summary of the development of the MSR and indicates that, out of the top 25 Mexican export categories to the United States, the MSR declined—to the detriment of Canada—for 20 categories over the 1990-2000 period. For 15 out of these 20 categories, Canada had established a market share advantage in 1990, while Mexico enjoyed a market share advantage for five categories in 1990. On the other hand, the MSR increased—to the benefit of Canada—for five categories in the same period. Canada enjoyed a market share advantage for two of these categories in 1990, and Mexico enjoyed a market share advantage for the other three categories in 1990.

Despite the fact that Canada experienced a decline in the MSR for a number of major Canadian export categories to the United States between 1990 and 2000—**motor vehicles** (with a decline in the ratio of 70.0%), **machinery and engines** (down 65.1%), and **articles of iron or steel** (down 47.2%)—a reversal of Canada's market share advantage in 1990, which established a Mexican market share advantage in 2000, only occurred for three categories: **beverages**; **glass and glassware**; and **optical and medical instrumentation**[2].

However, as is evident from Table 2, the developments of the MSR are neither uniform between categories over the 1990-2000 period nor between the 1990-1994 and 1994-2000 subperiods. Although the implementation of the NAFTA in 1994 may be the most obvious aspect to distinguish the two periods, there are a number of macroeconomic factors to consider.

During the 1990-1994 subperiod, the negative effects of the global recession resulted in very limited growth in annual Canadian real GDP, with a 1.9% decline in real GDP in 1991, while Mexico enjoyed substantial annual real GDP growth throughout this entire period. The exchange rate between the Canadian dollar and the Mexican peso was C$0.41/peso in 1990 and C$0.40/peso in 1994, i.e. a marginal decline in the value of the Mexican peso by 2%. Thus, exchange-rate differences between the Canadian dollar and the Mexican peso are too insignificant in this period to have had a serious effect on Mexican and Canadian exports to the United States.

However, the situation is rather different in the 1994-2000 period. First, the economic crisis experienced in Mexico led to a substantive economic restructuring and a decline in Mexican real GDP by 6.2% in 1995. As part of an integrated measure of the economic restructuring, Mexico devalued the peso by 47.2% to C$0.21/peso in 1995. In addition to the devaluation in 1995, the Mexican peso continued to slide against the Canadian dollar for the remainder of the decade to C$0.16/peso in 2000. The combined effective depreciation of the Canadian dollar/Mexican peso exchange rate of 61.2% in the 1994-2000 period was a major factor behind the faster growth in Mexican exports to the United States.

In addition, 1994 remains the starting point for sharply increased inflows of foreign direct investment (FDI) into Mexico. FDI flows into Mexico more than doubled between 1993 and 1994, and remained at or exceeded that level throughout the rest of the 1990s. The growth in FDI into Mexico also boosted Mexican exports to the United States.

For the majority of the 15 categories where Canada enjoyed an absolute market share advantage in 1990, the MSR declined between 1990 and 2000. The categories with significance to Canada include **motor vehicles** (with the MSR falling by 26.3% in the 1990-1994 period and by a further 59.3% in the 1994-2000 period), **machinery and engines** (with the MSR falling 32.7% between 1990 and 1994, and 48.1% between 1994 and 2000); and **furniture and lamp/fixtures** (with the MSR falling 15.4% between 1990 and 1994, and 15.7% between 1994 and 2000). The notable exception is **paper and paperboard**, Canada's 6th largest U.S. export product in 2000, where the MSR increased by 32.7% in the 1990-1994 period, but experienced a decline of 50.2% in the 1994-2000 period.

Electrical machinery and electronics is the only category among Canada's top 25 U.S. exports that is included in the group of categories where Mexico enjoyed an

2 With respect to beverages (including spirits and vinegar)—ranked as Canada's 25th largest export category to the United States in 2000—the decline in Canadian exports can, to a large extent, be explained by an increase in cross-licensing arrangements between U.S. and Canadian brewers and beverage producers, which has largely reduced the need to ship large quantities of beverages across the border. Optical and medical instrumentation ranked as Canada's 13th largest export category to the United States in 2000, and glass and glassware ranked as the 33rd largest. For both categories, the MSR was only marginally above unity in 1990 and moved to marginally favour Mexico in 2000.

absolute market share advantage in 1990 and where the MSR declined in the 1990-2000 period. For this category, a decline in the MSR by 32.0% in the 1990-1994 subperiod overshadowed an improvement in the MSR by 17.9% in the 1994-2000 subperiod. The improvement in the MSR in the 1994-2000 subperiod is largely explained by expanding Canadian shipments of telecommunications equipment. However, both Canada and Mexico can be expected to face increased competition in the electrical products, electronics and telecommunications sector from Asia in the future—not only from traditional Asian exporters to the United States such as Singapore, Hong Kong, Taiwan and Malaysia, but also increasingly from China.

The group of categories where Canada enjoyed a market share advantage in 1990 and where the MSR improved in Canada's favour includes **mineral oils and fuels** (ranked as the 2nd largest Canadian U.S. export category in 2000) and **pearls, precious stones and jewellery** (ranked 12th). Both categories experienced a substantive increase in the MSR in the 1990-1994 subperiod, which was followed by a marginal decline in the MSR between 1994 and 2000.

The MSR has increased between 1990 and 2000 for three categories where Mexico enjoyed an absolute market share advantage in 1990. All three categories recorded an increase in the 1990-1994 as well as in the 1994-2000 period. Although neither of these three categories are ranked very highly on the list of major Canadian export products to the United States, it is of interest to note that **toys, games and sporting goods**—ranked as the 35th largest category of Canadian exports to the United States in 2000—is one of the categories where Canada is enjoying an increase in the MSR.

Summary and Conclusions

Although Mexico has experienced tremendous growth in exports to the United States over the past decade, so far it has not seriously threatened Canada's position as the primary import source for the United States. In fact, Mexico's expanding market share in the United States has, to a large degree, been at the expense of Japan. In the future, Canada and Mexico alike may have to focus more on the emerging competition from China for market share in U.S. imports, particularly following China's recent entry into the World Trade Organization (WTO). Similarly, following the revival of the U.S. economy (expected in the latter part of 2002), Mexico, as well as Canada, will have to face increasing competition from other Asian economies. However, based on their respective export mix, it is likely that future growth in Asian exports to the United States will occur more at the expense of Mexican than Canadian exports and will consequently limit further growth in Mexico's share of U.S. imports.

The economic downturn in the U.S. economy is currently putting stress on a number of Mexican businesses relying on the United States as their product market. Recent reports[3] indicate that some Mexican auto-parts makers are experiencing increasing difficulties in servicing their debt following a drop in demand from the U.S. auto industry—their major client. A widespread extension of debt-servicing problems among Mexican companies can undermine the stability of Mexican banks and, in the longer run, can reduce the inflow of FDI on which Mexico has been relying for their export expansion into the United States.

Thus, on the supply side, there is a legitimate question about the degree to which the Mexican manufacturing sector servicing the U.S. import market can weather (a prolonged) downturn in the United States. Even if the United States can avoid a substantive contraction in import demand, the Mexican export sector, which is established on the assumption of a continued expansion in U.S. import demand, may still face profitability and debt-servicing problems.

As noted above, during the 1994-2000 period, Mexican and Canadian trade with the United States has been stimulated by the NAFTA. At the same time, the Mexican peso was continuously devalued in relation to the Canadian dollar. Consequently, it is extremely difficult to determine the extent to which the relationship between Mexican and Canadian imports to the United States has been affected by the NAFTA and to what extent the increase in U.S. imports from Mexico was influenced by import price elasticities triggered by the continued peso depreciation in this period. Recent developments indicate that the peso's slide versus the Canadian dollar has been halted—the peso appreciated against the Canadian dollar from C$0.15/peso in January 2001 to C$0.17/peso in October 2001. Thus, unless the peso currency depreciates substantially again, it is highly unlikely that Mexico will replace Canada as the primary source for imports into the United States in the foreseeable future.

3 "Mexico exporters hit," Wall Street Journal article reprinted in the Globe and Mail, October 22, 2001.