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CanadExport

Canadian Trade Review

A Quarterly Review of Canada's Trade Performance

First Quarter 2002

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

Trade Sector was Essential for Stellar Economic Performance in the First Quarter

Canada's real gross domestic product (GDP) increased by 6.0% on an annualized basis[1] in the first quarter of 2002—more than twice the rate recorded for the fourth quarter of 2001 (2.9%) and the best quarterly economic performance recorded since the fourth quarter of 1999. At this rate, the Canadian economy also outpaced the U.S. economy, which, according to preliminary estimates, grew by 5.6% in the first quarter. Increased exports and a drawdown of inventories were the main contributors to Canadian economic growth in the quarter. Robust consumer spending and a steep increase in housing investment fuelled domestic demand, some of which was met by growing imports. Manufacturing reversed five quarters of decline, which helped reverse four quarters of decline in exports overall and five quarters of decline in imports.

Table 1: Canada's Economic and Trade Indicators

Percent Change at Annual Rates First Quarter 2002 over Fourth Quarter 2001	
Real GDP *(annualized)*	6.0
Employment *(quarterly increase, level)*	170,000
Rate of Unemployment *(first quarter average in percent)*	7.8
Consumer Price Index *(first quarter 2002 over first quarter 2001, percent change)*	
All Items	1.5
Core *(excludes food and energy)*	2.0
Canadian $ in U.S. Funds *(first quarter average)*	0.6271
Exports of Goods and Services *(based on current dollars)*	12.1
Imports of Goods and Services *(based on current dollars)*	8.4

Source: Statistics Canada.

Job creation also increased during the quarter. A net increase of 170,000 jobs was reported for the entire quarter, although job growth was limited in February. Despite the growth in the number of jobs, the average unemployment rate rose to 7.8% from 7.6% in the previous quarter.

Overall, inflation in the first quarter was 1.5%, up from 1.1% in the last quarter of 2001, although core inflation (excluding food and energy) was 2.0%, up from 1.8% in the previous quarter. Inflation thus remained comfortably within the target range of 1% to 3% that has been established by the Bank of Canada.

The average U.S. dollar value of the Canadian dollar in the first quarter was US$0.6271—a marginal 0.9% depreciation from US$0.6328 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.) Unless otherwise noted, all figures, with the exception of investment figures, are expressed on an s.a.a.r basis.

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

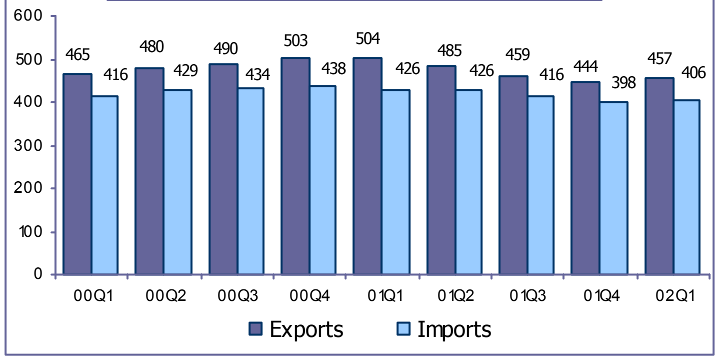
Both Exports and Imports Expand in the First Quarter

Exports of Canadian goods and services increased by 12.1% in the first quarter, with merchandise exports expanding by 12.9% (see Figure 1 for levels). Imports of goods and services increased at a rate of 8.4%, with merchandise imports growing at a slightly faster pace of 8.8%.

As is evident from Figure 2, shipments of energy and consumer goods experienced strong growth, while imports of forestry products, automotives and industrial products also expanded substantially.

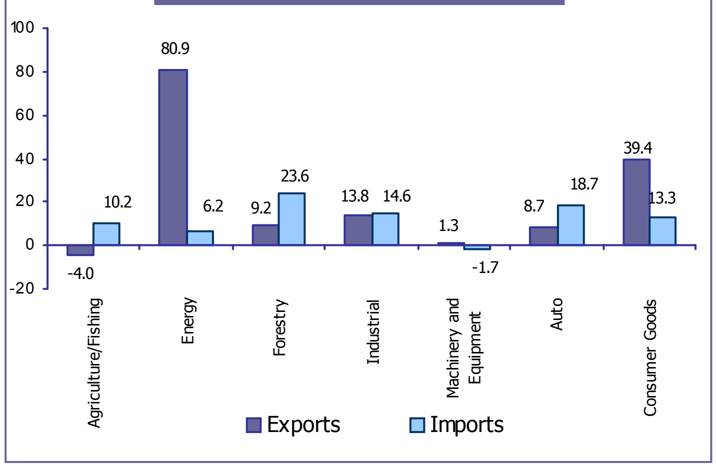
Exports to the U.S. and to the EU—in particular to the U.K.—expanded, while shipments to all other destinations declined. Imports from the EU and Japan declined, while imports from the U.S. and other countries increased. As a result of exports expanding at a more rapid rate than imports, the trade balance improved in the first quarter—in particular with the U.S. and the EU.

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



Source: Statistics Canada.

Figure 2: Canada's Trade by Commodity
First Quarter 2002 over Fourth Quarter 2001
(Annualized, Percent Change)

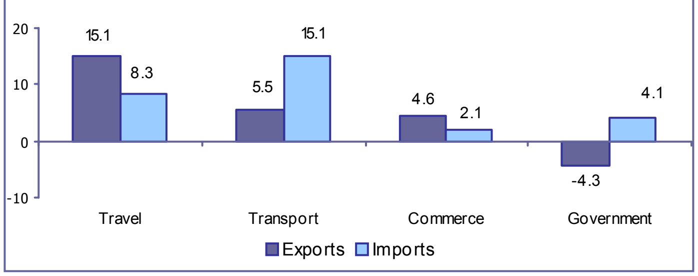


Source: Statistics Canada.

Services Trade Deficit Expands

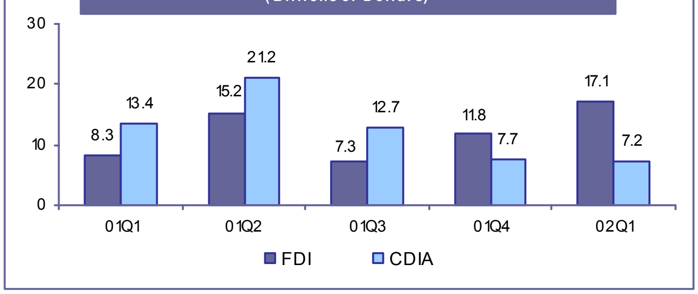
In the first quarter, a 6.2% increase in overall services exports led by travel was more than offset by a 6.3% increase in services imports (notably in travel and transport services). The net effect was a widening in the services deficit by $108 million to $6.0 billion. For details by type of services, see Figure 3.

Figure 3: Canada's Trade in Services by Type
First Quarter 2002 over Fourth Quarter 2001
(Annualized, Percent Change)



Source: Statistics Canada.

Figure 4: Foreign Direct Investment in Canada (FDI) and Canadian Direct Investment Abroad (CDIA)
(Billions of Dollars)



Source: Statistics Canada.

Canada Attracts Inward Foreign Direct Investment

In comparison with the same quarter in 2001, the first quarter of 2002 recorded a doubling of inward foreign direct investment (FDI), which was heavily concentrated in the energy and minerals sector. The U.S. was the primary source country for this expansion, accompanied by the EU. Although outward FDI in the energy and minerals sector grew substantially, declines in all other sectors combined to reduce the level of outward FDI by half compared with the first quarter a year earlier. Outward FDI declined to all destination countries and regions.

Canada Adds to Its Official International Reserves

Canada added $0.7 billion to its official reserve assets in the first quarter of 2002, compared to $2.5 billion added in the same quarter in 2001.

The Role of Imports in Canada's Economy

Overview

In today's world, the globalization of business, underpinned by increased international trade and investment, has compelled Canadian companies to embark on a wide-ranging effort at organizational and operational restructuring. Many, albeit not all, trade and investment barriers are gradually being dismantled, and the labour, capital and other advantages of one country or region are being combined with the technical and other strengths of another. The outcome is the creation of many new economic realities that, for the first time ever, are truly global in conception, administration and delivery. As part of this ongoing process of restructuring, businesses are often relying on imports to replace less efficient domestic suppliers and/or to increase intra-firm trade flows.

This special feature reviews the role of imports in the contemporary Canadian economy, with a particular focus on the role of imports as intermediate goods in Canada's exports.

At the most basic level, imports not only benefit the exporting country, they also provide benefits to the importing economy. For the Canadian consumer, for example, imports provide a greater variety of choice of products at more competitive prices. Canadian producers also benefit—from the use of imported parts or services as well as from the use of foreign machinery and equipment, which enables them to lower their costs. Thus, domestic producers are able to offer their products (final as well as intermediate goods) for sale more cost-effectively in the Canadian market or enhance their competitive position in international export markets.

Imports enrich the lives of Canadians and improve Canadian competitiveness in several ways. First, a major share of imports consist of final goods sold and consumed in the Canadian domestic market. For example, the demand for fresh fruits and vegetables by Canadian consumers over the winter months is largely met by imports.

Second, a large portion of imports consist of intermediate goods used as inputs in the processing and manufacture of goods and services in Canada. Goods and services generated in Canada encompass both final products and services intended for the consumer market and those intended as inputs for further processing. The two types of goods and services can in turn be destined for either the Canadian domestic market or export markets.

Third, certain imports consist of machinery and equipment, which are used by Canadian industry in the provision of final goods or services.

Imports thus are of significant benefit to our economy. Moreover, their role in Canadian economic activity has been on the rise for some time, as evidenced below:

- The ratio of imports of goods and services to GDP has increased from 18.0% in 1961 to 38.1% in the year 2001.
- The share of imports in the "apparent Canadian market" (i.e. net domestic shipments plus imports) has been on the rise over time and increases with the degree of processing.
- The share of imports in the "apparent market" for primary goods increased from 16.8% to 20.6% between 1965 and 1996. Primary goods are defined as agricultural, fishing, trapping, forestry, mining, crude oil and natural gas, and quarried products.
- The share of imports in the "apparent market" for manufactured goods jumped from 20.0% to 44.1% over 1965-1996.
- The share of imported inputs in the gross output of primary goods rose from 2.7% to 6.2% over 1965-1996, while for manufactured goods it increased from 10.0% to 23.1% over the same period.

What factors explain the ever larger role of imports in the Canadian economy? One contributing factor, as alluded to above, is the increasing sophistication of the Canadian consumer—both individual and industrial. Another factor is the decline in trade barriers, as epitomized by the outcome of various trade agreements, such as the Uruguay Round and the NAFTA. Yet another explanation might be the increased specialization, or fragmentation, of the production process across countries and regions. We examine this last explanatory factor in further detail below.

Vertical Specialization and the Import Content in Canadian Exports

Vertical specialization refers to the degree of specialization through the various stages of the production process as a good moves towards completion as a final product. For example, it takes many different manufacturers to produce the inputs needed for the assembly of an automobile—tires, chassis, seats, steering wheels and mirrors, to name a few. As mentioned above, the labour and other advantages of one country or region can be combined with the technical strengths of another to create new and different economic opportunities and modes of delivery and assembly. This is what economists refer to as vertical specialization, and imports are part of the process.

The level of vertical specialization provides an indication of how Canada benefits from increased trade by allowing our industries to specialize in areas where Canada has cost and production advantages over other countries. We note from Table 2 that the growth in vertical specialization has been more rapid in manufacturing than in the primary sector—3.3% versus 2.6% over 1965-1996, at average annual rates. Moreover, it is also evident from the table that growth in vertical specialization accelerated more rapidly over 1988-1996 compared to 1965-1988 in both the primary and manufacturing sectors. The increase in vertical specialization over this period is largely attributed to increased trade in industries benefiting from tariff reductions and/or elimination under the FTA/NAFTA agreements of the late 1980s and the early 1990s.[1] It is also of interest to note that two-way trade and vertical specialization have increased at a particularly rapid rate in industries previously protected, such as leather, textiles and clothing. On the other hand, the increased external orientation of industries facing very low tariffs prior to the FTA/NAFTA agreements—such as the electrical and electronic products industry—points to factors other than the FTA/NAFTA having contributed to increased trade exposure and vertical specialization.

It should be emphasized again that certain goods that Canada imports are used as inputs into other goods, transformed and, subsequently, exported. Tires, for example, are mounted on cars, trucks and vans that are sold to U.S. customers. A number of studies have examined the import content of exports.[2] Chief amongst their findings is that the import content of Canadian exports has been on the rise over 1986-1995, increasing from roughly one-quarter of the content to about one-third of the content. The import content of our exports increased in all industries, with the exception of mining, tobacco and miscellaneous manufactured goods. The automotive sector recorded the highest import content of exports in 1986 as well as in 1995, although the fastest growth in the import content of our exports over the entire period was recorded by the machinery and equipment and electronics sectors. Most interesting, however, is that the studies find that the increase in the import content of exports has been most notable in the sectors experiencing strong growth in exports. In hindsight, however, this is may be not that surprising in light of the trend towards globalization and increased specialization set out above.

Table 2: Evolution of Vertical Specialization in Canada, 1965-96

Vertical Specialization	1965	1988	1996	Avg. Annual Growth 1965-88	Avg. Annual Growth 1988-96	Avg. Annual Growth 1965-96
Primary sector	0.052	0.086	0.113	2.3%	4.0%	2.6%
Manufacturing sector	0.131	0.240	0.349	2.8%	5.5%	3.3%

Source: R. Dion, "Trends in Canada's Merchandise Trade," Bank of Canada Review*, Winter 1999-2000, p. 32.*
(Data in current dollars from input/output tables.)

Conclusions

Imports play a large and increasingly important role in Canadian economic activity and in the everyday lives of Canadians. They are present in our cars, in our food, in the video games that our children play, and in just about every other facet of our lives. Equally true, they are present in the goods and services we sell abroad. More importantly, imports are playing an increasing role in our activities. As consumers become more cosmopolitan and sophisticated, they are demanding a wider range of goods and services and a range of prices that cannot be met from domestic sources. And as Canadian manufacturers sell more and more abroad, they are scouring the marketplace, both at home and offshore, for cost-saving inputs.

Some of this demand, depending on the sector, will be met by imports, raising the conundrum that to export more we will have to import more. Thus, imports play, and will increasingly play, an important role in the Canadian economy.

[1] Analysis undertaken by Trefler, Industry Canada, in Dion, "Trends in Canada's Merchandise Trade," *Bank of Canada Review,* Winter 1999-2000.

[2] G. Cameron, and P. Cross, "The Importance of Exports to GDP and Jobs," *Canadian Economic Observer*, November 1999, Statistics Canada; C. Coronel, "Import Benefits to Canada's Exporters," mimeo, DFAIT/EET, March 2001.