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CanadExport

Canadian Trade Review

A Quarterly Review of Canada's Trade Performance–Second Quarter 2004

This review reports on Canada's continued economic growth in the second quarter of 2004, and highlights our trade and investment performance in key sectors and markets.

Broad-based Export Growth Pushes Up Quarterly Economic Expansion

Growth in exports helped to accelerate the Canadian economy's rate of expansion in the second quarter, as real gross domestic product (GDP) expanded by 4.3% (annualized)[1] —up from 3.0% the previous quarter.

South of the border, final estimates indicate that US GDP expanded in the second quarter by 3.3% -down from 4.5% in the first quarter. Growth in Canada's other major markets in the second quarter varied: in the EU it was 2.0%, while in Asia, Japan registered 1.7% and China 9.6% (the latter comparing second quarter GDP with the same quarter a year earlier).

The economic expansion in Canada was led by robust export growth, while consumer spending leveled off in the second quarter. The housing boom continued, albeit at a slower pace, and business investment in plant and equipment only advanced modestly.

Exports of goods and services advanced at a blistering 41.0%, while imports expanded by 29.1%. The surge in exports spurred a 1.6% increase in manufacturing output as 17 of 21 manufacturing groups—led by transport equipment manufacturers— expanded over the quarter. Similarly, increased exports and imports also supported expanded rail and truck transportation services.

With exports advancing at a faster pace than imports, the trade balance improved by $ 14.6 billion in the quarter. However, an offsetting $5.8 billion decline in investment income reduced the improvement in the current account to $8.7 billion.

Table 1: Canada's Economic and Trade Indicators

Percent Change at Annual Rates Second Quarter 2004 over First Quarter 2004	
Real GDP *(annualized)*	4.3
Employment *(quarterly increase, level)*	130,400
Rate of Unemployment *(quarterly average)*	7.3
Consumer Price Index *(first quarter 2004 over first quarter 2003)*	
All Items	2.2
Core *(excludes food and energy)*	1.7
Canadian $ in U.S. funds *(average for quarter, level)*	0.7358
Exports of Goods and Services *(annualized, current dollars)*	41.0
Imports of Goods and Services *(annualized, current dollars)*	29.1

Source: Statistics Canada

Job creation in Canada resumed in the second quarter, after a net loss in the first quarter. The net quarterly increase was 130,400, with some 92% added as full-time positions. With this development, the average unemployment rate for the quarter fell to 7.3% from 7.4% the previous quarter.

Inflation increased to 2.2% in the second quarter after falling to 0.9% in the previous quarter. Core inflation increased more moderately—from 1.3% to 1.7%— over the quarter.

The Canadian dollar was down 3.0% vis-à-vis the American dollar in the second quarter—the quarterly average value of the "Loonie" was 73.58 US¢.

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

Prepared by the Trade and Economic Analysis Division (EET)

International Trade Canada
Commerce international Canada

Canada

Trade and Investment Highlights

Goods Exports Growth Outpaces Goods Imports Expansion

Exports of Canadian goods and services expanded by 41.0% in the second quarter (Figure 1). Goods exports expanded by 46.7%, while services exports increased by a much more modest 7.3%.

Imports of goods and services expanded by 29.1% in the quarter, reflecting a 35.0% increase in commodity imports and an 4.3% expansion in services imports.

Merchandise exports increased $40.7 billion (up 46.7%), as all major sectors experienced advances (Figure 2). Automotive sector exports advanced $8.2 billion (or 43.8%), industrial goods $8.1 billion (or 52.7%), the energy sector $7.9 billion (or 62.6%), the machinery and equipment sector $6.4 billion (or 32.1%), the forestry sector $5.6 billion (or 76.6%), agriculture products $3.5 billion (or 56.3%) and consumer goods $1.2 billion (or 29.7%).

Merchandise imports advanced by $26.4 billion —led by the machinery and equipment sector (up $8.3 billion or 38.2%), industrial goods (up $6.6 billion or 46.1%), the automotive sector (up $3.6 billion or 21.3%), the energy sector (up $3.3 billion or 80.7%) and consumer goods (up $2.4 billion or 23.1%).

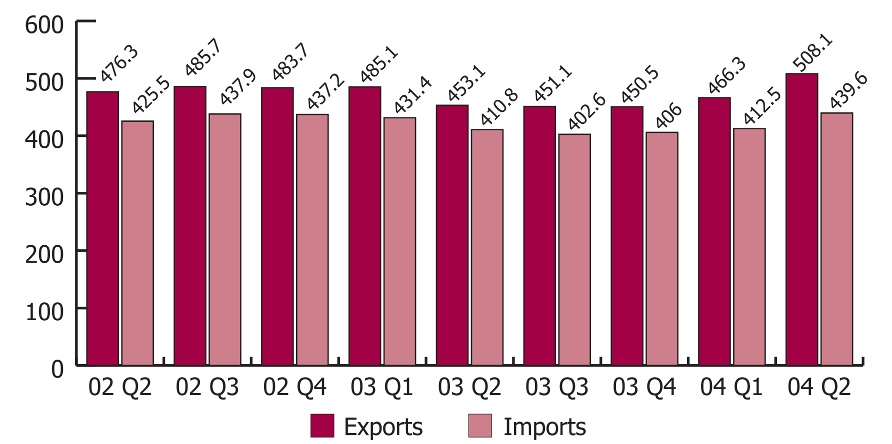
On a destination basis, merchandise exports to the US increased by $33.1 billion, or 46.4%, and accounted for just over 80% of the increase in overall quarterly exports. Shipments to non-OECD countries advanced by $3.1 billion (up 57.0%), and were up by $2.2 billion to Other OECD countries (up 77.9%), by $1.5 billion to the EU (up 26.4%), and by $0.9 billion to Japan (up 38.5%).

Merchandise imports from the US expanded by $15.5 billion (up 29.0%). Imports from Other OECD countries increased by $4.0 billion (or 101.9%), were up by $3.8 billion (or 45.3%) from non-OECD countries, advanced by $2.8 billion (or 37.6%) from the EU, and grew by $0.4 billion (or 15.0%) from Japan.

With goods exports expanding at a faster pace than goods imports, the

Figure 1: Canada's Trade in Goods and Services

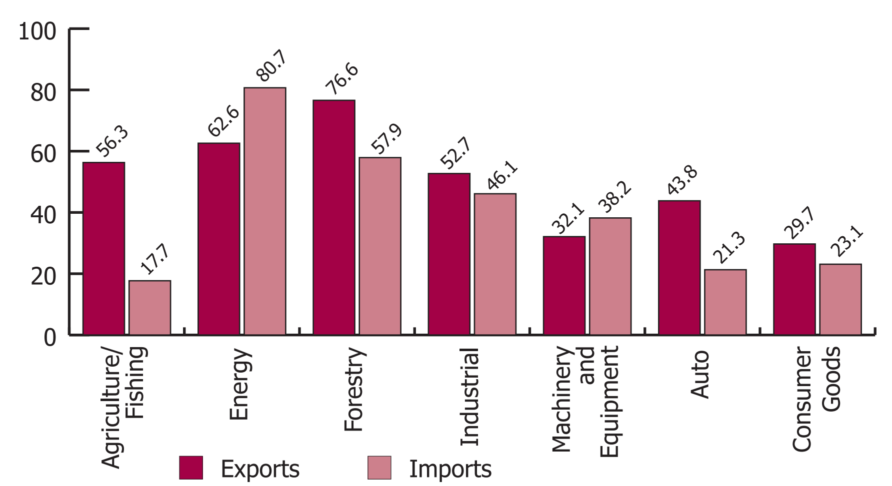
(Billions of Dollars, Annualized)



Source: Statistics Canada

Figure 2: Canada's Trade by Commodity

Second Quarter 2004 over First Quater 2004
(Annualized, Percent Change)



Source: Statistics Canada

merchandise trade balance increased by $14.3 billion in the quarter, to $80.2 billion on an annualized basis. A $17.5 billion increase in the merchandise trade balance with the US combined with an $0.5 billion improvement in the trade balance with Japan were partially offset by deteriorating trade balances with Other OECD countries (down $1.8 billion), with the EU (down $1.3 billion), and with non-OECD countries (down $0.7 billion).

Both Services Exports and Imports Expand

Services exports also increased by $1.1 billion in the second quarter. Gains were particularly strong in the travel sector (up 26.7% or $0.9 billion) and the transport sector (up 21.7% or $0.5 billion), while exports of government services increased more modestly (Figure 3). Offsetting these increases was a $0.4 billion decline in commercial services exports (down 5.2%).

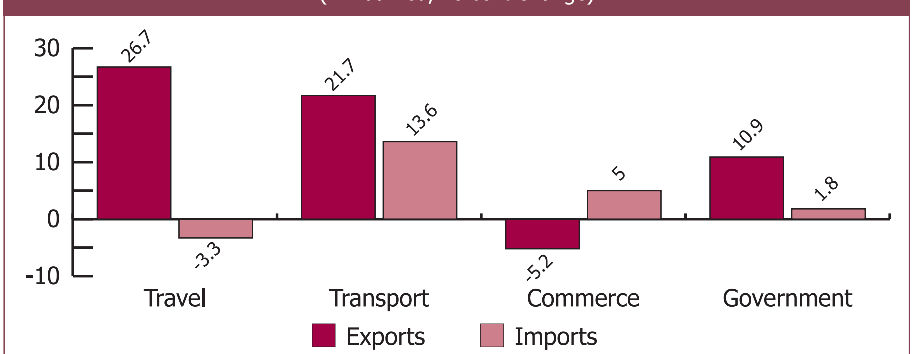
Services imports advanced $0.8 billion. Imports of transport and commercial services each increased by $0.5 billion, while government services imports stayed flat and travel services imports fell by $0.2 billion. Overall, the quarterly services trade deficit narrowed to $11.7 billion on an annualized basis from $12.0 billion the previous quarter.

Outward Foreign Direct Investment (FDI) Flows Exceed Inward FDI Flows

Flows of Canadian Foreign Direct Investment Abroad (CDIA) were $33.0 billion in the second quarter of 2004 - substantially up from the $2.7 billion recorded in the same quarter in 2003. Increased CDIA flows in the finance & insurance sector accounted for some $22.0 billion of the increase, accompanied by smaller advances in the energy & mineral sector (up $3.8 billion), the wood & paper sector and the services & retail sector (up $2.9 billion each). Only machinery & transport recorded a slight decline in CDIA flows—down $0.9 billion over the same quarter a year earlier.

Figure 3: Canada's Trade in Services by Type

Second Quarter 2004 over First Quater 2004
(Annualized, Percent Change)



Source: Statistics Canada

Regionally, outward flows to the US were up substantially (up $26.8 billion) together with enhanced flows to the EU (up $3.5 billion) and Japan (up $0.3 billion). These advances were only marginally offset by declining CDIA flows to Other OECD countries (down $39 million) and non-OECD countries (down $299 million).

Foreign Direct Investment (FDI) flows into Canada were $3.3 billion in the second quarter of 2004, down from $5.7 billion in the same period a year earlier. The largest decline in inflows was in machinery & transport (down 2.0 billion), followed by energy & minerals (down $585 million), services & retail (down $164 million) and finance & insurance (down $131 million). Only wood & paper registered an increase in the second quarter (up $429 million).

From an origin perspective, inflows fell as a result of a drop in US investments (down $2.6 billion), which were only partially offset by increased inflows from Japan (up $118 million) and the EU (up $105 million).

Canada's Official International Reserves Remains Unchanged

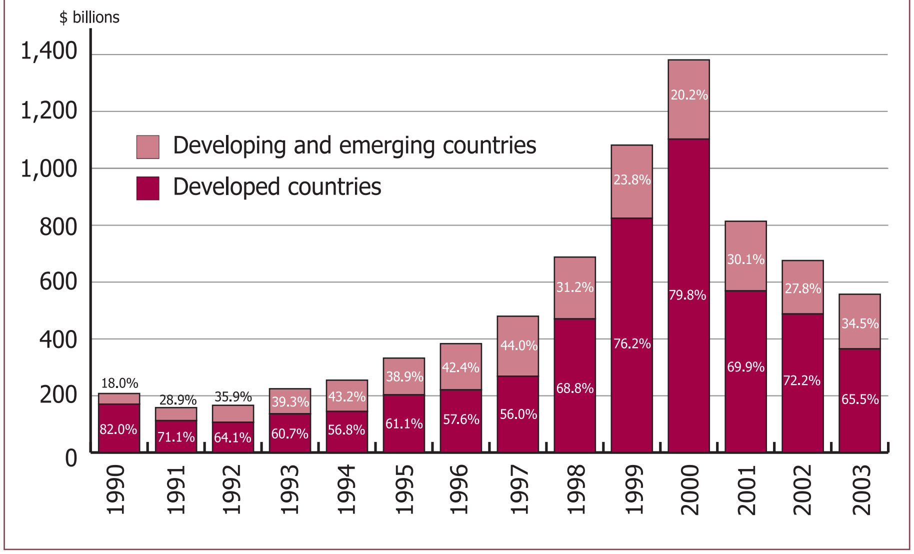
Canada reduced its official reserves holdings by $243 million in the second quarter of 2004, compared with a $229 million reduction in the same quarter in 2003.

Foreign Direct Investment (FDI) in China

Overview

Throughout the 1990's investment inflows into the developing economies increased steadily. As a result, their share in total world investment increased until the late 1990's, when a spree of merger and acquisition activity – largely confined to the developed countries- reversed this trend. However, with the global slowdown beginning in the year 2000, world FDI flows fell markedly, particularly in the developed economies, and the share of the developing countries began to rise again (Figure 4).

Figure 4: World FDI Inflows



Source: United Nations Conference on Trade and Development (UNCTAD); World investment Report 2004 (www.unctad.org/wir)

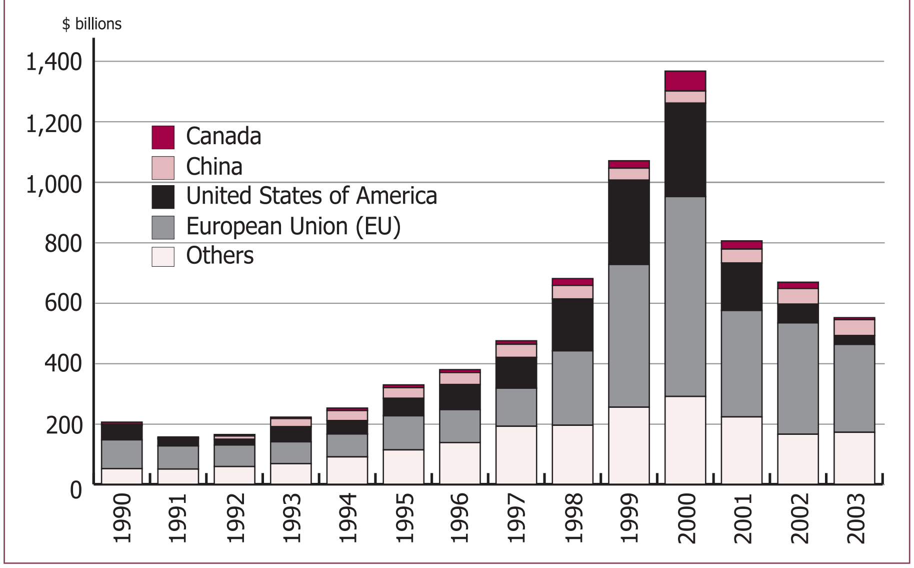
China attracts an increasing share of world FDI flows

Historically, the United States (US) has attracted the largest amount of annual FDI flows (Figure 5). However, over the 1990s, China2 began attracting increasingly larger amounts of FDI flows. Accordingly, China's share of global FDI inflows jumped from 1.7% in 1990 to peak at 10.7% in 1995.

As investment inflows into the US slumped markedly between 2001 and 2003, China supplanted the US as the top country for FDI inflows last year.

From a different perspective, China increased its share of global FDI inflows into developing countries from 9.3% in 1990 to 27.7% in 2003 and its share of FDI into Asian developing countries from 14.4% to 49.9% over the same period.

Figure 5: World FDI Inflows Into Select Countries and Regions



Source: United Nations Conference on Trade and Development (UNCTAD); World investment Report 2004 (www.unctad.org/wir)

With the increase in these inflows, China's share of the global FDI stock thus advanced from 1.3% in 1990 to 6.1% in 2003. China's share now lags only those of the US (18.8%), the UK (8.2%) and Germany (6.6%).

1 Although, when aggregated, FDI flowing into the European Union (EU) countries accounted for about half of the world total in 2000-2003.

2 For the purpose of this analysis, China refers to the People's Republic of China, but excludes Hong Kong and Macau.

FDI inflows are important to China's economic development

Investment inflows into China have become increasingly important to China's economic development, as outlined in Table 1.

The share of FDI inflows in China's Gross Fixed Capital Formation (GFCF) jumped from 1.9% in 1985 to 14.8 % in 1995 before settling back to 12.4% in 2003. Thus, with the increase in FDI inflows, the share of FDI flows in GFCF in China in 2003 has surpassed the ratio for developing countries in Asia (9.3%) as well as the share for all developing countries (10.0%).

Inward FDI flows amounted to 6.1% of exports and 3.9% of imports in 1985 and rose to 24.1% and 27.8%, respectively, in 1995. However, as China's exports and imports expanded at a faster pace than FDI inflows in the following years, these shares have slipped back to 17.6% and 19.2%, respectively, in 2001. These shares nevertheless exceeded the averages registered for all developing countries in 2001 – 10.2% and 10.7% for the share of FDI flows in exports and imports, respectively.

In per capita terms, FDI inflows increased from US$ 1.6 per person in 1985 to US$ 37.10 in 2001. Due to its sizeable population, China lagged somewhat the average per capita FDI inflow into developing countries in 2001 (US$ 40.80), but is still more than 11 times greater than that for India (US$ 3.30 per person).

Table 1: FDI in China's Economy

	1985	1990	1995	2000	2001	2002	2003
FDI inflows, share of Gross Fixed Capital Formation (GFCF)	1.9%	3.5%	14.8%	10.3%	10.5%	11.50%	12.4%
FDI inflows, share of Exports	6.1%	5.6%	24.1%	16.4%	17.6%	n.a.	n.a.
FDI inflows, share of Imports	3.9%	6.5%	27.8%	19.8%	19.2%	n.a.	n.a.
FDI inflows per capita (US$)	1.6	3.1	29.9	32.5	37.1	n.a.	n.a.
FDI inward stock, share of GDP	3.4%	7.0%	19.6%	32.2%	33.2%	35.4%	35.6%
Foreign Investment Enterprises (FIE):							
Share of industrial output	n.a.	2.3%	14.3%	31.3%	28.0%	33.4%	n.a.
Share of total trade	n.a.	n.a.	n.a.	n.a.	n.a.	53.1%	57.1%
Share of exports	n.a.	n.a.	n.a.	n.a.	n.a.	52.1%	55.8%
Share of imports	n.a.	n.a.	n.a.	n.a.	n.a.	54.2%	58.6%

n.a. indicates data not available

Source: United Nations Conference on Trade and Development (UNCTAD); World investment; Ministry of Commerce of the People's Republic of China -MOFCOM (www.fdi.gov.cn)

Cumulative inward FDI, or the inward FDI stock in China, has expanded faster than Gross Domestic Product (GDP) over the last 20 years. Therefore, the size of the inward FDI stock in relation to GDP has increased from 3.4% in 1985 to 35.6% in 2003, and now exceeds the average relative size in Asian developing countries (30.3%), as well as the average for all developing countries (31.4%). However, it should be pointed out that among other East Asian countries in 2003, the relative size of inward FDI stock reached 50.6% in Vietnam and 57.2% in Malaysia, while inward FDI stock only represented 5.4% of GDP in India.

In parallel with increasing inward FDI, the role of foreign investment enterprises (FIE) in China's economy has also seen considerable expansion. The FIE's share of Chinese industrial output increased from 2.3% in 1990 to 33.4% in 2002. In 2003, FIE's accounted for 55.8 % of exports, 58.6% of imports, and a combined 57.1% of total trade.

Geographical distribution of FDI in China

Economic reforms in the late 1970s and the establishment of Special Economic Zones (SEZs) in the southern provinces of Guangdong and Fujian laid the foundation for opening China to FDI inflows. In the 1980s, additional SEZs were established in Hainan and in 14 coastal cities. Although additional economic reforms in the 1990s opened the rest of China to FDI, China's eastern region attracted 88% of inward

Table 2: FDI inflow by sector, 2000

Sector	Approved Projects		Implemented projects		
	Number	Value (US$ million)	Value (US$ million)	Share (percent)	
Agriculture, forestry, stock raising, fishery	821	1,483	676	1.3%	*
Mining industry	162	506	583	1.1%	*
Manufacturing industry	15988	46,048	27,516	53.0%	*
textile industry	801	2,015	1,392	5.1%	**
chemical materials and products industry	986	2,596	1,796	6.5%	**
pharmaceuticals manufacturing	268	912	523	1.9%	**
general machine manufacturing	613	1,634	1,047	3.8%	**
special equipment manufacturing	689	1,068	528	1.9%	**
electronic and telecommunication equipment	1,529	11,379	4,627	16.8%	**
Electric power, coal gas and water utilities	107	2,015	1,392	2.7%	*
Construction industry	233	2,596	1,796	3.5%	*
Geology survey and management of water resources	7	912	523	1.0%	*
Transportation, warehousing, post and telecom services	306	1,634	1,047	2.0%	*
Wholesale, retail and restaurants	852	1,068	528	1.0%	*
Finance and insurance	5	11,379	4,627	8.9%	*
Real estate	684	1,227	2,242	4.3%	*
Society services	2679	15	5	0.0%	*
Hotel	72	1,440	1,045	2.0%	*
Health, sports and social welfare	31	1,435	858	1.7%	*
Education, culture and art, broadcasting and film	19	79	76	0.1%	*
Science, research and technology services	100	5,232	4,658	9.0%	*
Others (unallocated)	353	5,049	4,357	8.4%	*

* share of the value of implemented projects, 2000
** share of the value of implemented projects in the Manufacturing sector

Source: Ministry of Commerce of the People's Republic of China -MOFCOM (www.fdi.gov.cn)

FDI between 1983 to 1998, despite accounting for only 29% of China's GDP. On the other hand, the central region (which accounts for 29 % of GDP) attracted a mere 9% of FDI and the western region (accounting for 23% of GDP) only attracted 2% of FDI[3].

FDI inflows by sector

FDI into China is heavily concentrated in the manufacturing sector (Table 2). In 2000, manufacturing accounted for over half of FDI inflows, followed by science, research and technology services (9.0%), finance and insurance (8.9%), and real estate (4.3%). Within the manufacturing sector – of those industries for which we have data - electronic and telecommunication equipment accounted for 16.8% of inward investment followed by chemicals (6.5%), and textiles (5.1%).

FDI by type

The leading form of FDI into foreign investment enterprises in China is equity joint ventures, which accounted for 42.9% of inward FDI stock in 2002 (Table 3). Wholly foreign-owned enterprises (37.0%) and contractual joint ventures (18.5%) account for the bulk of the remainder of FDI in China.

Major source countries for FDI into China

The top sources for FDI inflows into China in 2002 are listed in Table 4. For this year, Hong Kong provided

3 "Foreign Direct Investment in China: Some Lessons for Other Countries", W. Tseng and H. Zegreb, IMF Policy Discussion Paper, PDP/02/3, 2002

Table 3: Inward FDI Stock in China, by type, 2002

Type of FDI	Approved Projects				Implemented Projects	
	No.	Share (percent)	Value US$ million	Value Share (percent)	US$ million	Share (percent)
Total (all types)	424,196	100.0%	828,059	100.0%	447,966	100.0%
Equity Joint Venture	225,883	53.2%	327,548	39.6%	192,204	42.9%
Contractual Joint Venture	52,965	12.5%	163,319	19.7%	82,783	18.5%
Wholly Foreign -owned Enterprise	145,165	34.2%	332,538	40.2%	165,616	37.0%
Joint Exploration	183	0.0%	4,654	0.6%	7,364	1.6%

* share of the value of implemented projects, 2002

Source: Ministry of Commerce of the People's Republic of China -MOFCOM (www.fdi.gov.cn)

Table 4: FDI Inflows into China; Major Sources Countries, 2002

Unit: US$ million

Country/Region	Number of projects: Number	Number of projects: Source country share (percent)	Approved projects: Value (US$ milllion)	Approved projects: Source country share (percent)	Implemented projects: Value (US$ milllion)	Implemented projects: Source country share (percent)
Total	34,171	100.0%	82,768	100.0%	52,743	100.0%
Hong Kong	10,845	31.7%	25,202	30.4%	17,861	33.9%
Virgin Islands	1,959	5.7%	12,650	15.3%	6,117	11.6%
USA	3,363	9.8%	8,156	9.9%	5,424	10.3%
Japan	2,745	8.0%	5,298	6.4%	4,190	7.9%
Taiwan	4,853	14.2%	6,740	8.1%	3,971	7.5%
Korea, Rep.	4,008	11.7%	5,282	6.4%	2,721	5.2%
Singapore	930	2.7%	2,785	3.4%	2,337	4.4%
Cayman Islands	199	0.6%	2,258	2.7%	1,180	2.2%
Germany	352	1.0%	915	1.1%	928	1.8%
UK	334	1.0%	1,142	1.4%	896	1.7%
West Samoa	533	1.6%	1,878	2.3%	879	1.7%
Canada	708	2.1%	1,148	1.4%	588	1.1%
France	162	0.5%	879	1.1%	576	1.1%
Netherlands	127	0.4%	516	0.6%	572	1.1%
Mauritius	245	0.7%	705	0.9%	484	0.9%

Source: Ministry of Commerce of the People's Republic of China -MOFCOM (www.fdi.gov.cn)

more than one third of FDI inflows (down from about 50% during the 1990s), followed by Virgin Islands (11.6%), USA (10.3%), Japan (7.9%), Taiwan (7.5%), and the EU (7.0%).

Although China offers many seemingly lucrative investment opportunities to foreign investors, there are a number of structural impediments that investors need to take into account. These include such hurdles as a complex incentive and tax system, the possibility of political intervention in investment decisions, and a weak legal structure to implement regulations safeguarding the interests of foreign investors. For these reasons, a certain portion of foreign investment projects approved by the Chinese authorities may never come to fruition, or may be severely delayed.[4]

China's share of outward FDI from major OECD countries

China's share of total outward FDI stocks in select OECD countries over 1990-2001 is presented in Table 5. In 2001, only four OECD countries registered FDI holdings in China exceeding one percent of total their FDI stock – Korea (17.0%), Japan (3.1%), Germany (1.1%) and Poland (13.6%). Among these, Korea and Poland have distinctly focussed on enhancing their respective FDI holdings in China, while Japan and Germany have been increasing their FDI holdings in China at a slower pace.

4 See "Doing business in China – fools rush in", The Economist, August 7, 2004, p.50, for a sample of obstacles encountered by foreign investors in China.

From a North American perspective, it is evident that China has become a more prominent destination for US outward FDI holdings – the share accounted for by China increased from 0.4% in 1995 to 0.8% in 2001. On the other hand, the share of Canada's FDI stock invested in China stayed in the 0.2-0.3% range throughout the same period.

Outward FDI from China

Many economists foresee that the next stage in China's economic development will be as a more prominent provider of outward FDI– not only into neighbouring Asian countries but also into a wide range of sectors in developed and developing non-Asian countries. Despite the fact that outward FDI from China has been more modest than inward FDI, a number of Chinese companies have emerged into trans-national companies (TNC) with substantive overseas investments. Thus, in 2001 twelve of the fifty largest TNCs in developing countries were located in mainland China[5]. Adding approved outward FDI flows from 1979-2002[6] reveals that Asia was the destination for 58.7% of China's outward FDI. Hong Kong was the preferred Asian destination, accounting for 43.6%, followed by Thailand (2.3%), with every other Asian country accounting for less than 2% each. The United States, which accounted for 8.9% of China's outward FDI, ranked as the second largest destination country, followed by Canada (4.7%). Thus, North America accounted for a combined share of 13.6% (Mexico did not appear among the top 30 destination countries). Europe accounted for 6.0% of China's FDI position in 2002.

Although not reflected in this data, China appears now to be actively pursuing a course of outward acquisitions, such as the merger in 2003 of the television and DVD operations of TCL (China) and Thomson (France), which resulted in TCL majority control of the joint company. Similarly, in December 2003 China National Bluestar (Group) Corp. announced its intentions to acquire a 49 percent stake in the Korean Ssangyong Motor Co.[7], which had been for sale for the last three years since the collapse of its Korean parent company, the Daewoo Group. Most recently, there has been some interest shown by Chinese-based companies in established Canadian-based national resource enterprises, as well as those in several other countries.

Table 5: China's share of total outward FDI position in selected OECD countries

Reporting OECD country/region	1990	1995	2000	2001
Asia				
Australia	0.0%	0.1%	0.2%	0.2%
Japan	0.9%	n.a.	3.1%	3.3%
Korea	0.9%	18.6%	17.0%	15.3%
Europe				
France	0.1%	0.3%	0.4%	n.a.
Germany	0.1%	0.4%	1.1%	n.a.
Netherlands	n.a.	0.2%	0.4%	n.a.
Poland	n.a.	0.2%	13.6%	n.a.
Switzerland	n.a.	0.3%	0.4%	n.a.
United Kingdom	0.0%	0.1%	0.3%	n.a.
North America				
Canada	0.0%	0.2%	0.2%	0.2%
United States	0.1%	0.4%	0.8%	0.8%

Source: OECD - International Investment Statistics (on-line electronic database)

5 "China: an emerging FDI outward investor," UNCTAD, Division on Investment, Technology and Enterprise Development; E-brief, December 4, 2003.

6 Ibid; percentage shares calculated from data in Table 2 and Table 3 of the document.

7 "China's Bluestar shifts gears," *Globe and Mail (Wall Street Journal)*, p. B6, December 23, 2003