SUPPLEMENT CanadExport

Canadian Trade Review

A Quarterly Review of Canada's Trade Performance

Fourth Quarter 2003

This review reports on the resumption of Canada's economic growth in the fourth quarter of 2003, and highlights our trade and investment performance in key sectors and markets.

Falling Energy Prices Hamper Export Recovery in the Fourth Quarter

The Canadian economy ended last year on a positive note, as real gross domestic product (GDP) expanded by 3.8% (annualized)[1] in the fourth quarter—up from 1.3% the previous quarter. This performance helped to lift overall annual real GDP growth for 2003 to 1.7%. However, this growth was down from the 3.3% expansion registered in 2002. South of the border, preliminary estimates indicate that US GDP expanded by 4.1% in the fourth quarter and by 3.1% for all of 2003. Growth in Canada's other major markets in the fourth quarter varied: in the EU it was 1.6%, while in Asia both Japan and China registered very high growth rates of 6.4% and 9.9%, respectively (the latter comparing fourth quarter GDP with the same quarter a year earlier).

Table 1: Canada's Economic and Trade Indicators	
Percent Change at Annual Rates **Fourth Quarter 2003 over Third Quarter 2003**	
Real GDP *(annualized)*	3.8
Employment *(quarterly increase, level)*	172,600
Rate of Unemployment *(quarterly average)*	7.5
Consumer Price Index *(fourth quarter 2003 over third quarter 2003)*	
All Items	1.7
Core *(excludes food and energy)*	1.9
Canadian $ in U.S. funds *(average for quarter, level)*	0.7599
Exports of Goods and Services *(annualized, current dollars)*	-0.2
Imports of Goods and Services *(annualized, current dollars)*	2.0

Source: Statistics Canada

Spending by Canadian consumers remained flat in the final quarter of 2003 — a result of a cooling down of the home construction boom and a drop in car and truck purchases. Most of the economic expansion was accounted for by inventory build-up in the retail and wholesale sectors (largely of cars and trucks) and in the agriculture sector (grain and live animal inventories). Output in manufacturing expanded by 2.0% in the fourth quarter—the first increase in five quarters. This reflected a number of positive factors, including a rebound from the electricity black-out in Ontario in the previous quarter, the reopening of international borders to some Canadian beef products, robust housing construction in both Canada and the US, and higher demand for motor vehicle parts from US assembly plants.

Export performance, however, was hampered by further strengthening of the Canadian dollar. Despite this impediment, real exports expanded by 3.2% in the quarter, although nominal exports registered a 0.2% decline.

Similarly, real imports expanded by 4.2% in the quarter, while nominal imports grew by 2.0%.

Falling exports, increased imports and a drop in investment income resulted in a $4.8 billion decline in the current account balance in the fourth quarter.

Job creation in Canada continued at an accelerated pace. The net quarterly increase was 143,800, with some 83% as added full-time positions. With this development, the average unemployment rate for the quarter fell to 7.5% from 7.9% the previous quarter.

Inflation continued to decline over the quarter, falling to 1.7% from 2.1%. Core inflation, however, increased over the quarter— from 1.7% to 1.9%.

The Canadian dollar was up 4.9% vis-à-vis the American dollar in the fourth quarter—the quarterly average value of the "Loonie" was 75.99 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 Decline while Goods Imports Expand

Exports of Canadian goods and services fell a modest 0.2% in the fourth quarter (Figure 1). An 11.3% quarterly increase in services exports was not sufficient to offset a 1.8% decline in merchandise exports, which were adversely affected by the rising dollar and slumping energy prices.

Imports of goods and services expanded by 2.0% in the quarter, reflecting a 0.8% increase in commodity imports and an 8.1% expansion in services imports.

A $1.8 billion quarter-over-quarter decline in merchandise exports was largely concentrated in the energy sector (down $6.6 billion, or 37.0%) as prices fell, and the machinery and equipment sector (down $2.3 billion, or 10.2%). Also contributing to the reduction in exports were declines in forestry products and in consumer goods (Figure 2). Capping the losses were increases in industrial goods (up 28.7%, or $4.2 billion), agriculture products (up 8.6%, or $0.6billion), and automotive shipments (up 5.0%, or $1.1 billion). Without the negative effect of falling energy prices, aggregate export performance in the quarter would have shown a healthy recovery.

Merchandise imports experienced a modest increase of $0.6 billion (up 0.8%) in the fourth quarter. The machinery and equipment sector registered the largest quarterly drop in imports (down $3.0, billion or 11.7%), while agricultural and forestry products experienced more limited declines. On the other hand, imports of automotive products increased by 16.4% ($2.8 billion), while energy imports expanded by 14.6% (up $0.6 billion), despite lower energy prices.

Merchandise exports to the US fell by 7.8% or $6.5 billion, in the quarter, while those to Japan were down 12.5%, or $0.3 billion. These declines were only partially offset by increases to the EU (up 71.5%, or $3.2 billion) and to Other OECD countries (up 75.4%, or $1.8 billion).

Merchandise imports from the EU were down 19.3% or $1.8 billion, whereas imports from the US declined more modestly in the quarter, down 0.5%, or $0.3 billion, on an annualized basis. These declines were, however, more than offset by a small increase in imports from Japan (up 4.0%) and, more substantially, expanded goods imports from Other OECD countries (up 20.7% or $0.9 billion) and from non-OECD countries (up 21.3% or $1.8 billion).

With goods imports expanding and goods exports declining, the merchandise trade balance fell by $2.4 billion in the quarter, to $60.3 billion on an annualized basis. A $6.2 billion decline in the merchandise trade balance with the US, combined with declines in the trade balance with Japan (down $0.4 billion) and with non-OECD countries (down $1.8 billion), were only partially offset by increases in the merchandise trade balance with the EU (up $5.1 billion) and with Other OECD countries (up $0.9 billion).

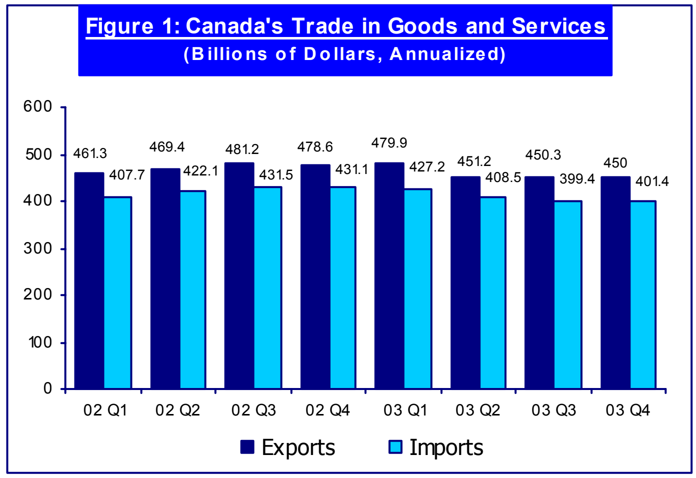

Figure 1: Canada's Trade in Goods and Services
(Billions of Dollars, Annualized)

Source: Statistics Canada

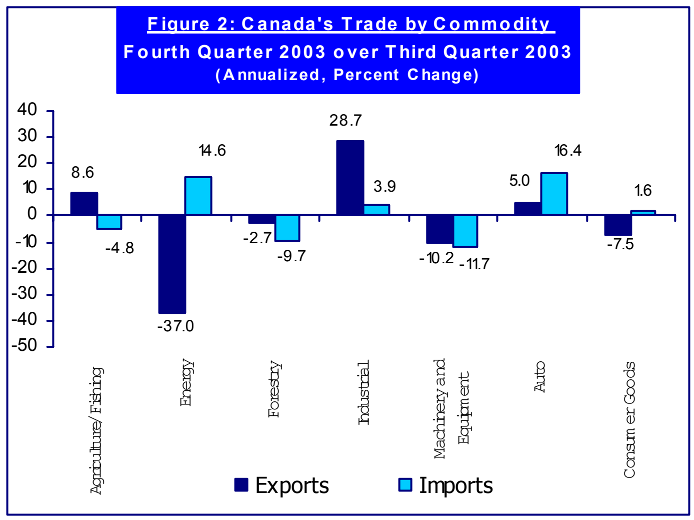

Figure 2: Canada's Trade by Commodity
Fourth Quarter 2003 over Third Quarter 2003
(Annualized, Percent Change)

Source: Statistics Canada

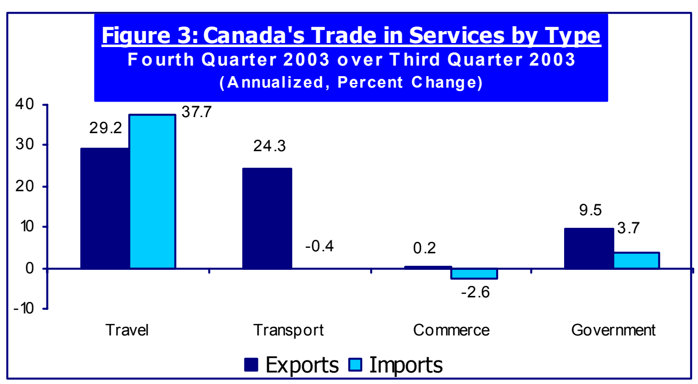

Figure 3: Canada's Trade in Services by Type
Fourth Quarter 2003 over Third Quarter 2003
(Annualized, Percent Change)

Source: Statistics Canada

Both Services Exports and Imports Expand

Canadian services exports increased by 11.3% in the fourth quarter, as all sub-sectors expanded (Figure 3). The expansion was particularly strong in the travel sector (up 29.2% or $ 0.9 billion) and the transport sector (up 24.3% or $0.5 billion).

Services imports advanced $1.3 billion or 8.1%. Increased travel by Canadians during the quarter pushed travel services imports up $1.6 billion or 37.7%. Transport services imports declined slightly and imports of commercial services fell by $220 million or 2.6%, while government services imports remained flat. Overall, the services trade deficit narrowed to $11.7 billion on an annualized basis in the fourth quarter from $11.9 billion in the previous quarter.

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

Flows of Canadian Direct Foreign Investment Abroad (CDIA) were $17.1 billion in the fourth quarter of 2003 - slightly up from $16.2 billion recorded in the fourth quarter in 2002. Increased CDIA flows in the energy, machinery & transport, and services & retail sectors were offset by a substantial drop in the finance & insurance sector.

Regionally, CDIA flows to the US declined (down $9.7 billion), whereas flows to the EU (up $8.3 billion) and non-OECD countries (up $2.9 billion) expanded.

Foreign Direct Investment (FDI) in Canada experienced a net outflow of $1.3 billion in the fourth quarter of 2003. This compares unfavourably with inflows of $5.6 billion over the same quarter a year earlier— a $6.9 billion turnaround. All sectors, with the exception of finance & insurance, registered net outflows over the fourth quarter—most notably for the machinery and transport ($-1.1 billion) and energy (-$0.7 billion) sectors. Substantial FDI outflows back to US investors ($2.1 billion) were only partially offset by more limited FDI inflows from the EU ($0.4 billion), non-OECD countries ($0.2 billion) and Japan ($0.1 billion).

Canada's Official International Reserves Remain Unchanged

Canada reduced its official reserves holdings by $1.7 billion in the fourth quarter of 2003, compared with a $0.6 billion reduction in the same quarter in 2002.

Key Trade and Investment Highlights for Year 2003

Merchandise Trade

Merchandise exports fell by 3.1% ($12.8 billion) in 2003—led lower by reduced shipments to the US. Merchandise imports declined by 4.3% ($15.1 billion), as reduced imports from the US, the EU, and Japan were only partially offset by increased imports from other markets.

As a result of goods imports declining more than exports, the overall merchandise trade surplus expanded by $2.4 billion over 2002 to $60.2 billion in 2003. Separately, the merchandise trade balance with the UK and Japan improved in 2003, while the trade balances with all other markets declined.

Merchandise Trade by Region

Canada's annual merchandise exports to the US declined by 4.5%, or $15.6 billion, and imports fell by 6.2%, or $15.7 billion in 2003. Consequently, the bilateral merchandise trade surplus expanded by $137 million in 2003—from $92.1 billion to $92.2 billion.

Both merchandise exports and imports from Japan declined over 2002. Exports to this region declined by 3.8%, or $386 million, while imports fell by 9.1%, or $1.0 billion. As a result, the bilateral trade deficit with Japan was reduced by $688 million to $753 million last year.

In 2003, merchandise trade relations with the EU were characterized by large swings in goods trade with the UK. Merchandise exports to the UK expanded by $1.3 billion in 2003, as overall goods exports to the EU grew by $1.4 billion, or 6.2%. At the same time, goods imported from the UK fell by $1.4 billion as part of the overall $1.3 billion, or 3.5%, decline in total goods imported from the EU.

China is Canada's fourth largest export market and the second largest source of imports. Last year, in a climate of overall declining goods exports and imports, Canadian exports to China expanded by 12.9% while imports from China increased by 16.1%. With these developments, Canada's bilateral trade deficit with China widened to $13.9 billion in 2003 from $11.9 billion the previous year.

Lastly, goods shipped to Mexico declined by 9.0%, or $218 million, over 2002, while imports from Mexico fell by 4.4%, or $559 million. The bilateral trade deficit with Mexico thus narrowed by $341 million in 2003, to $10.0 billion.

Merchandise Trade by Commodity Group

In 2003, merchandise exports declined in all sectors, except for Energy. Exports of Automotives fell by 9.4% (or $9.1 billion), those of Machinery were down 8.3% (or $8.0 billion), Forestry goods were off by 7.2%

(or $2.7 billion), and Industrial and Agricultural goods exports were both down 5.2% (or $3.6 billion and $1.6 billion, respectively). Finally, Consumer goods exports declined 3.1% (or $0.5 billion). Partially offsetting the losses was a surge in Energy exports, which increased by 22.8%, or $11.3 billion, largely due to increased energy prices.

Similar to the case for exports, goods imports also declined in all sectors, except for Energy. Imports of Machinery declined by 7.2% (or $7.7 billion), Automotives imports were down 6.3% (or $5.1 billion), Industrial goods were off by 5.5% (or $3.8 billion), Forestry imports were down 3.7% (or $0.1 billion), while Agricultural goods imports fell by 1.2% (or $0.3 billion), and Consumer goods imports were down 0.5% (or $0.2 billion).

With these developments, the merchandise trade balance for Energy improved by a healthy $8.3 billion in 2003 to more than offset the key declining merchandise trade balances for Automotives (down $4.0 billion) and Forestry (down $2.6 billion).

Services Trade

Services exports also experienced an overall decline in 2003, led by a 12.8%, or $2.1 billion, drop in Travel services exports. Visits to Canada and related expenditures by foreigners were negatively affected by the SARS outbreak in Toronto. A $1.0 billion improvement in Commercial services exports was largely offset by a decline in Transport services, while Government services exports were flat. On the other hand, services imports expanded in 2003, as all services sectors registered increases. Commercial services imports expanded by $0.5 billion, foreign Travel expenditures by Canadians grew by $0.3 billion and Transport services imports advanced by $0.3 billion.

With declining services exports and expanding services imports, the services trade deficit widened by $3.1 billion to reach $11.5 billion in 2003. A $2.4 billion deterioration in the Travel services trade balance and a $1.1 billion decline in the balance for Transport services were only partially offset by a $0.4 billion improvement for Commercial services, while the Government services balance stayed flat.

Foreign Direct Investment

The flow of both Foreign Direct Investment (FDI) into Canada and Canadian Foreign Direct Investment Abroad (CDIA) slowed in 2003—FDI flows were down 33.6% compared to 2002 and CDIA flows declined by 74.5%. CDIA flows slipped to $30.0 billion in 2003 compared to $45.2 billion in 2002. Declining CDIA in the Finance & insurance (down $14.2 billion over 2002) and Machinery &transport sectors (down $2.4 billion) was only partially offset by $1.2 billion increase in the energy sector.

FDI inflows contracted from $32.3 billion in 2002 to $8.3 billion in 2003, with the declines concentrated in the Energy (down $14.1 billion), Machinery & transport (down $5.7 billion), and Services & retailing (down 2.3 billion) sectors.

Thus, as in the two previous years, outward CDIA flows outpaced inward FDI flows in 2003. Of particular note, the difference between outward and inward FDI flows widened to $21.8 billion in 2003 from $12.9 billion in 2002.

On a regional note, the declines in outward and inward FDI flows from the US were the principal reasons for the reduced flows observed in 2003. CDIA flows to the US fell from $14.0 billion to $6.4 billion, as the US share of CDIA declined to 21.2% from 30.9% a year earlier. Inward FDI flows from the US fell at an even faster pace than outflows—from $24.7 billion in 2002 to $4.4 billion in 2003. The share of annual inward FDI flows originating from the US thus declined from 76.4% in 2002 to 53.0% in 2003. With these developments, CDIA to the US exceeded FDI inflows from the US in 2003, a reversal of the situation seen in previous years.

Inward FDI flows from all other regions also declined, but less dramatically than those from the US. Thus, the EU increased its share of inward FDI flows from 12.5% in 2002 to 24.7% in 2003 and Japan increased its share from 3.1% to 9.9%.

The CDIA position, or stock, was $398.2 billion at the end of 2003, down from $431.8 billon in 2002. The strengthening of the Canadian dollar in 2003, and the associated re-evaluation of the CDIA position, accounted for much of the decline. The inward FDI position increased somewhat last year, from $349.4 billion in 2002 to $357.7 billion.

Portfolio Investment

Canadian net investments in foreign securities (bonds and stocks) was $12.5 billion in 2003, down from $25.0 billion in 2002— a $14.4 billon reduction in stock holdings was only partially offset by a $2.0 billion increase in bond holdings. On the inward investment side, foreign investment inflows favoured Canadian securities (up $14.3 billion over 2002) over bonds (down $12.0 billion).

Official International Reserves

Canada reduced its holdings of Official International Reserves by $4.7 billion in 2003, compared to a $298 million decline in 2002.

Current Account

With the trade and investment developments outlined above, Canada's current account surplus expanded to $25.8 billion in 2003 from $23.4 billion the previous year. Although exports of goods and services declined by a larger amount than imports - down $14.8 billion and $14.0 billion, respectively—the current account surplus was enhanced by a $4.0 billion net reduction in interest payments to foreign investors.