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CONSUMERS LOSING MOMENTUM

When it comes to global slowdowns, events rarely unfold smoothly. In mid-summer, the global economy was still humming along, and it looked like the forecasters were once again underestimating world growth. Central banks around the world were on inflation watch, and it looked a lot like a repeat of the early 1970s – rapid global growth, capacity problems aplenty and inflation. How quickly things changed in August. Almost overnight, subprime became both street language and an adjective for crisis, 2007 style. And in a radical about-face, central banks were pumping liquidity into the system on a daily basis.

A bolt out of the blue?

Headlines around the world created the impression that the August turbulence came from nowhere. But this U.S.-centered event was in the works for some time, and the surprise is that it didn't happen sooner. And it was a well-worn slowdown indicator, the U.S. housing sector, that reacted first. Official interest rate hikes that began in June 2004 ended two years and 425 basis points later, exposing excesses in the U.S. housing market that had been building for five years. The outcome? A recession-style plunge in key U.S. housing indicators that sparked a surge of mortgage defaults. Financial service firms around the globe are already reporting big losses, and the defaults have yet to run their course.

Contagion or containment?

When economic slowdown spills into financial markets, fear of contagion is never far away. For the moment, the recent actions by central banks have quelled those fears. In fact, many market watchers are seeing an end to this turbulent interlude in a matter of weeks. Optimists almost always surface at this point in the economic cycle, with stories of how different things are this time – a soothing message of hope that almost invariably disappoints.

Undoubtedly there have been significant changes to the structure of the global economy since the last big slowdown. Just the same, it is hard to imagine that the current housing slowdown will not spread to the broader economy. With home equity no longer the stash of spare cash it has been for the last five years, U.S. consumers have already reined in spending. Moreover, employment growth has weakened significantly and confidence is waning. Long the engine of the economy, consumers are now a burden – over the coming 12 months, U.S. consumer spending growth is expected to be a drag on the rest of the economy.

Not just a U.S. phenomenon

It is equally hard to believe that a U.S. slowdown will not spread to the rest of the world. At 20% of world GDP, the U.S. economy has been a growth engine for at least the last decade. And consumers are 70% of the U.S. economy, its most important trade link with the rest of the world. At the same time, technology and increased trade have knit global economies together more closely than they have ever been. Like cyclists in a tight race for the finish, the world's economies are crowded together, and when one slows, the whole pack feels the effects.

Initially, the slowdown looked lop-sided, confined to U.S. borders. This prompted talk of a world economy decoupled from the U.S. malaise, able to continue cranking out rapid growth. But weakness has traversed oceans. Markets in Europe are more vulnerable to slowdown than was previously thought. European consumers, shocked by developments in global financial markets in the summer, are now spending at a slower pace. At the same time, Japan's recovery has been short-circuited by consumer retrenchment.

Emerging markets not immune

Emerging markets will also be affected. True, the economic numbers are still looking quite good, but in time the cracks are sure to show. Despite the significant economic deepening that has happened since the last major global slowdown, emerging markets' domestic economic base has not yet matured to the point that it can sustain growth independently. Even the large, fast-growing markets like China and India do not yet have this capacity. Recent studies underline the continued strong linkages between emerging markets and demand from the developed world. But the impact of slower world demand will not be instant. It will likely be 2008 before slowdown shows up in the data, and even then it may be masked by increases in inventory.

Financial market turbulence caused ripples in emerging markets, and as creditors re-evaluated positions, interest rate spreads widened. While the moves in some cases were large, the more dramatic moves were confined to a small group of the riskiest markets. For the most part, rate increases were far more modest than in past episodes. Why? Well, the slowdown is still in its infancy. But more importantly, emerging markets have in general adopted stronger fiscal and monetary policies, and accumulated reserves to increase resilience in periods of downturn. So while current headwinds affect overall growth, emerging markets are expected to fare relatively well during the global economy's soft spot.

Recession? Not likely

Normally, the U.S. housing market slowdown we are seeing would lead to a recession. And in recent weeks, the likelihood of a U.S. recession has risen to about 50:50. At this point, it is difficult to say whether the U.S. will teeter into recession, or narrowly avoid it as in 2001. Much depends on confidence, which is fickle at the best of times, and prone to rapid change. But there are good fundamental reasons to believe that the economy will only slow, and then revive in 2009. The U.S. economy has harnessed the forces of globalization so well that productivity growth has remained unusually strong at a late point in the cycle. That has preserved liquidity, which has kept investment strong, and allowed for non-inflationary wage acceleration as resources grew thinner. And the weaker greenback has been a boon for U.S. exporters. Although job growth has slowed, economic growth suggests that modest employment growth can be sustained during the downturn – no outright decline, as in normal recessions.

At present, the U.S. is the planet's most recession-prone economy. In the absence of a recession in the U.S., it is unlikely that the world economy will experience one. In fact, as growth slows and competition intensifies, the process of globalization is likely to intensify, deepening trade linkages and broadening the reach of global supply chains.

The effect at home

To date, Canadian economic numbers have been surprisingly strong. In contrast to our southern neighbours, our housing market is still on a high and consumers are still happily spending. Even with the strong dollar, exporters have hung in there, managing to eke out small growth even in certain sectors that are more exposed. But in a strange twist, slower global growth will actually bring needed relief to exporters.

Strength in the global economy has ignited demand for oil, base metals and now agricultural products – commodities that Canada specializes in. Prices have skyrocketed, and have taken our dollar with them. And as the dollar has risen, speculators have nudged it higher. At current levels, the loonie is a huge threat to near-term exports. Fortunately, slower world growth is expected to cut demand for commodities. Along with increased supplies, this tempered demand is expected to bring prices back down swiftly, although to higher average levels than in the past. This is expected to lower demand for our currency – we expect to see it below 90¢ U.S. by the end of 2008.

Even so, total exports will just manage to grow in 2008. Key price gains have put exports on track to increase by 3.7% this year, but for 2008 growth will be more than halved to 1.5%. Consumer goods, automotive products and base metals will weigh down overall growth next year, the effect of weaker U.S. and global demand. The forestry sector and service industries will also be weak performers. On the upside, the agri-food, fertilizer and energy industries are all expected to post strong growth in 2008.

Reflecting the outlook, Canadian export diversification is expected to continue in the forecast period. For 2008, exports to the developed world are expected to rise by less than 1%. In contrast, export growth in emerging markets as a whole is projected at 11%.

Is the turbulence over?

The global slowdown is still in its early stages. Weakness is only just spilling into other developed markets, and will take time to infect emerging markets. Judging by past episodes of turmoil, we will likely see more turbulence in the coming months. But all told, we don't expect the extent of turmoil seen in the mid- to late-1990s, or the wild fluctuations seen in certain emerging markets in the 1980s.

The bottom line

Preparing for slowdown is never pleasant. It rarely happens in exactly the same way and for the same time span as in the past. We can take solace that on balance, the world has a more sound structural platform than in the past, and should get through the weak spot without a major pile-up. And sooner than you think, we will all be back to worrying about the tricky side of a rebound: shortages, capacity constraints and looming inflationary pressures.

Peter G. Hall
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Table 1: GLOBAL GDP FORECAST BY COUNTRY (Growth)

Top Markets	% Share of World Economy (2006)	Global Outlook (growth) 2006	2007 (f)	2008 (f)
NAFTA	23.2	3.0	2.0	2.1
United States	19.7	2.9	2.0	2.0
Canada	1.7	2.7	2.3	2.6
Mexico	1.8	4.8	2.7	3.1
Western Europe	19.4	2.5	2.5	2.1
United Kingdom	3.2	2.8	2.6	2.0
EMU	14.6	2.4	2.5	2.1
Other Western Europe	1.6	3.4	2.7	2.3
Japan	6.3	2.2	1.9	1.7
Australia & New Zealand	1.2	2.5	2.4	3.0
Asia & Pacific total	30.2	9.0	8.7	8.1
China, P.R.: Mainland	15.1	11.1	11.0	10.0
India	6.3	9.2	8.2	7.9
Asian NIEs	3.4	5.0	4.4	4.1
ASEAN-4	3.5	5.0	5.5	5.5
Other East Asia & Pacific	0.6	7.7	7.0	6.6
Other South Asia	1.3	6.6	6.2	6.0
Eastern Europe & Central Asia	7.0	6.9	6.6	5.6
Russia	2.6	6.7	6.8	5.9
South America	5.2	5.6	5.5	4.6
Argentina	0.9	8.5	7.4	5.1
Brazil	2.6	3.7	4.3	4.1
Central America	0.6	6.8	5.4	4.3
Middle East & North Africa	3.9	5.4	5.5	5.5
Sub-Sahara Africa	2.0	5.2	7.0	6.4
Industrialized Countries	**51.7**	**3.1**	**2.4**	**2.2**
Developing Countries	**48.3**	**7.3**	**7.7**	**7.0**
Total Global Economy	**100.0**	**5.4**	**4.9**	**4.5**

Source: EDC Economics. 2006 is actual data, while 2007 and 2008 are forecast.
Asian Newly Industrialized Economies (NIE) are Hong Kong, Singapore, South Korea and Taiwan.
ASEAN-4 are Indonesia, Malaysia, Philippines and Thailand.

Canada's Export Outlook

Canadian exports are on track to rise by 3.7% in 2007, a significant improvement over the 0.7% advance experienced in 2006. But this year's headline number masks a mixed performance across various industries. Shipments of commodities and resource-based intermediate goods posted substantial gains in 2007 on the back of strong global demand and firmer pricing. Agri-food exports also benefited from higher prices for grains and robust demand conditions. Aerospace, rail equipment, advanced technology and industrial machinery all made solid advances. On the downside, significant declines were experienced in forestry, automotive, telecom equipment and consumer goods. Tourism, business travel, financial services and engineering are also expected to show weak results once the final year-end numbers are tallied up.

Recent months have seen Canadian exports lose momentum however, as a number of headwinds have come to bear, including a stronger dollar, deteriorating economic conditions south of the border and related fallout from the sub-prime mortgage turmoil. As the U.S. and global economies shed growth in the months ahead, Canadian export growth will follow suit. For 2008, we expect Canada's foreign sales to slow to growth of 1.5%, less than half the pace set in 2007.

On a geographic basis, most of the export strength in 2007 was in non-U.S. markets, with developing markets showing the largest percentage gains. Indeed, Canadian merchandise shipments to developing markets were up more than 20% in 2007, continuing the strong gains seen over the past few years. Countries such as Brazil, China, India, Russia and Mexico proved to be very strong markets for Canadian exporters in 2007. Industrialized markets in Western Europe were also bright spots for Canadian companies during the past year, while sales to Japan and the Asian NIEs made more modest gains.

Looking ahead to 2008, we expect this geographic dichotomy to continue with Canadian merchandise exports to emerging markets rising by an average of 11% compared with an average rise of less than 1% for the industrialized countries. Canadian sales of goods and services to the developing world are forecast to reach $50 billion in 2008.

We should see an easing in export growth across most of Canada's major industries through the coming year. Nevertheless, some sectors will fare better than others. Agri-food exports are forecast to rise by 11% in 2008, boosted by strong wheat and grain sales. Fertilizer shipments are expected to increase by 10% next year, following an estimated gain of 25% in 2007. Energy shipments are forecast to rise by 6%, on increases in crude oil, natural gas and coal. After strong gains in 2007, export receipts for ores and metals are projected to decline by 12% in 2008 – the result of a softer price environment. Chemicals and plastics should experience a small decline next year, also the result of weaker prices.

After a dismal 2007, the forestry sector is expected to show modest gains in 2008. Next year's improvement will be mostly the result of small price gains as producers engage in supply management through mill closures and downtime. We do not expect any significant turnaround in demand conditions. The U.S. housing slump is expected to continue through 2008, impacting Canadian producers of lumber and wood products. In addition, U.S. newsprint demand is likely to remain weak. Pulp exports advanced nicely in 2007, but the dollar value of sales is expected to moderate in 2008 as new global capacity puts downward pressure on prices.

Exports of telecom equipment are forecast to grow a modest 1% in 2008, while shipments of advanced technology goods are forecast to rise by around 2%. These numbers look rather weak, but when the large price drops are taken into account the performance is not all that bad. Indeed, volume shipments[1] for advanced technology equipment are expected to rise by 6% in 2008. Exports of industrial machinery are forecast to rise 4% in 2008, in line with this year's expected performance. Canadian companies are taking advantage of worldwide investment in machinery and equipment, especially in the agriculture, mining and energy sectors.

Aerospace exports in 2007 performed much better than we had anticipated earlier in the year. Strong growth in parts, components, business jets and helicopters has been augmented with improving regional jet and turbo-prop orders. Active order books should allow Canadian aircraft and parts manufacturers to make steady gains through 2008, albeit at a slower pace of growth than recorded during the past 12 months.

Consumer goods, furniture and household items have been hit particularly hard by the slump in U.S. housing and no relief is in sight. The other major sector showing lower exports is automotive, where sales are down an estimated 6% in 2007. In addition, Canadian auto parts producers will see their shipments crimped by lower North American vehicle production. For 2008, auto exports are projected to stabilize, as U.S. vehicle sales level off and the restructuring of the Detroit Three nears completion.

Canadian service receipts are expected to show little growth in 2007 once the final year-end numbers come in. Tourism, business travel, construction and financial services are the main drags on overall export receipts this year. The stronger Canadian dollar and higher gasoline prices certainly discouraged inbound travel from the United States in the past couple of years. Lower gas prices and an easing in the Canadian

[1]Export volumes refer to physical shipments, which net out the impact of price adjustments.

Table 2: CANADIAN EXPORT FORECAST BY SECTOR

Main Sectors	CAD bn (2006)	% Share of Total Exports (2006)	Export Outlook (% Growth) 2006	2007 (f)	2008 (f)
Agri-food	31.9	7.7	4.5	14.5	11.3
Energy	87.2	21.2	-0.5	5.2	5.9
Forestry	39.6	9.6	-8.9	-8.3	3.5
Chemical & Plastics	36.1	8.8	4.3	8.5	-0.6
Fertilizer	4.0	1.0	-9.4	25.9	10.5
Ores & Metals	52.8	12.8	24.1	20.4	-12.0
Other Industrial Products	7.0	1.7	-2.5	-0.9	-0.2
Aircraft & Parts	10.2	2.5	0.3	11.3	5.2
Rail & other Transportation Equip.	2.0	0.5	2.8	4.3	-0.4
Telecom Equipment	7.0	1.7	1.8	-6.2	1.0
Advanced Technology	13.4	3.3	-4.1	3.3	2.2
Industrial Machinery & Equip.	26.6	6.5	2.5	3.2	4.4
Motor Vehicles & Parts	75.7	18.4	-6.6	-6.3	1.5
Consumer Goods	9.6	2.3	-6.5	-8.3	-7.0
Special Transactions	8.3	2.0	4.9	-1.6	2.3
Total Goods Sector	411.3	86.0	0.7	4.1	1.5
Total Services Sector	67.2	14.1	0.4	1.1	1.8
Total Exports	**478.5**	**100**	**0.7**	**3.7**	**1.5**
Memorandum					
Total Volumes		100.0	1.1	-0.2	1.3
Total Goods (ex. Energy)	324.1	67.7	1.0	3.9	0.3
Total Goods (ex. Autos & Energy)	248.5	51.9	3.6	7.0	-0.1

Source: EDC Economics. 2006 is actual data, while 2007 and 2008 are forecast.

Table 3: CANADIAN MERCHANDISE EXPORT FORECAST BY COUNTRY

Top Markets	CAD bn (2006)	% Share of Total Exports (2006)	Export Outlook (% Growth) 2006	2007 (f)	2008 (f)
NAFTA					
United States	336.7	81.9	-1.9	1.1	0.7
Mexico	4.0	1.0	25.4	17.3	9.9
Western Europe					
United Kingdom	9.2	2.2	20.8	28.4	-4.2
Eurozone	15.5	3.8	14.2	9.8	-0.1
Other Western Europe	3.7	0.9	12.4	47.4	-0.2
Central & Eastern Europe	1.8	0.4	21.5	13.7	6.4
Russia	0.8	0.2	54.6	22.2	12.9
Asia & Pacific					
Japan	9.2	2.2	2.8	3.1	1.9
China	7.2	1.7	8.1	32.3	6.0
Asian NIEs	6.4	1.6	12.3	6.8	3.6
ASEAN-4	2.1	0.5	16.3	19.9	13.4
India	1.5	0.4	48.6	8.4	6.1
Other Asia	1.1	0.3	33.9	8.9	2.0
Oceania	2.1	0.5	10.1	-1.4	4.4
South America (ex. Brazil)	2.2	0.5	13.4	38.4	19.5
Brazil	1.3	0.3	20.2	13.8	9.0
Central America	1.7	0.4	12.3	7.9	8.2
Middle East	2.5	0.6	13.4	34.7	26.6
Africa	2.3	0.5	24.3	30.6	10.4
Total Goods Exports	**411.3**	**100.0**	**0.7**	**4.1**	**1.5**
Total to Developing Markets	**28.5**	**6.9**	**18.4**	**23.9**	**10.9**
Total to Industrialized Countries	**382.8**	**93.1**	**-0.4**	**2.7**	**0.6**

Source: EDC Economics. 2006 is actual data, while 2007 and 2008 are forecast.
The Asian Newly Industrialized Economies (NIE) are Hong Kong, Singapore, South Korea and Taiwan.
ASEAN-4 are Indonesia, Malaysia, Philippines and Thailand.

dollar may provide some relief for tourism in 2008, but not enough to fully offset a weaker U.S. economy and new U.S. passport requirements. Service exports are forecast to grow by 1.1% in 2007 and by 1.8% in 2008. The uptick in 2008 comes primarily from our expectations of a rebound in financial services and a small rise in tourism during the latter half of the year.

Provincial Export Outlook

The past year witnessed a wide variation in international export growth across the provinces, and the coming year is shaping up for more of the same. During 2007, those provinces with a large share of energy, mining and agri-food in their export mix generally performed above the national average. These include Newfoundland and Labrador, Nova Scotia, Manitoba, Saskatchewan and Alberta. Nearly all provinces reported a significant pullback in forestry exports, the lone exception being Nova Scotia where the re-opening of a paper mill late in 2006 boosted 2007 shipments.

Parts of the country that rely more heavily on manufactured goods (particularly autos, telecom equipment and consumer goods) experienced slower export growth over the past year. The divergence between exports of commodities (energy, fertilizers, grains and industrial metals) and manufactured goods should narrow in 2008 as prices for most resources pull back. However, autos, rail equipment, chemicals, consumer goods and telecom are expected to underperform – a situation that introduces some downside risk for Ontario and Quebec.

International exports for **Newfoundland and Labrador** are expected to rise 17% in 2007. This year's growth has been broad based, with energy and mining (iron ore, copper and nickel) leading the way. Transportation equipment, although a small part of the province's export bundle, notched up large gains in 2007. As in other provinces, Newfoundland's forestry exports were down in the past year. Export growth is forecast to slow to 5% in 2008 as lower prices for crude oil and ores offset increased output. Seafood is also expected to moderate in 2008. **Prince Edward Island**'s exports are forecast to finish 2007 with an increase of 5%. The past year saw gains in agri-food, industrial goods, transportation equipment and machinery partially offset by tepid sales of wood products and consumer goods. Next year should see a moderation in exports for the Island's leading industries, including agri-food, industrial goods and transportation equipment.

Nova Scotia's exports recovered in 2007, rising an estimated 7% – gains in energy, forestry, industrial goods and automotive more than offset weakness in agri-food, machinery and equipment (M&E), and consumer goods. Export growth is forecast to slow to 3% in 2008. Declines in agri-food, industrial goods and consumer goods will be joined by a slower pace of activity in the energy, forestry and auto sectors. Following a decline of 3% in 2006, **New Brunswick**'s international export sales are on track to grow by 5% in 2007, largely on strength in energy, mining, metals, fertilizers and chemicals. Shipments are forecast to accelerate a little in 2008, growing by 6%. Next year's increase comes mainly from energy, and to a lesser extent, M&E, as most other sectors post modest declines.

Quebec export growth slowed to an estimated 2.7% this year, due to lower forestry prices and falling sales of automotive products and consumer goods. Bright spots this year include petroleum products, electricity, metals, chemicals and aerospace. The outlook for 2008 will be dogged by a weakening global economic environment, which will cause foreign-bound shipments to pull back by 1.4%. Industrial goods and consumer products will be the main drags on Quebec's export sales, with most other sectors registering modest growth.

Following a year of declining sales, **Ontario**'s exporters are on track to make a modest rebound in 2007 despite the continued struggles of the manufacturing sector and, in particular, the automotive sector. Ontario's exports are expected to increase 2.4% in 2007 driven, in large part, by an excellent performance in metals and chemicals. We expect Ontario's exports to decline by almost 1% in 2008 as commodity prices ease amid softer U.S. and global demand conditions. On a more positive note, automotive exports should stabilize in 2008 as U.S. vehicle sales bottom out.

With gains concentrated in primary industries, **Manitoba** ranks among the best export performers across the country this year. Exports are likely to end the year with growth of 15%. Although the outlook going forward is generally positive, waning U.S. consumer demand combined with a stronger Canadian dollar are beginning to take a toll on Manitoba exports. As such, growth is projected to moderate to 7% in 2008. Despite weakness in energy and forestry, **Saskatchewan**'s export sector is performing strongly this year. Total exports are expected to rise by 15% in 2007, while non-energy sales should finish the year with growth of nearly 30%. Overall export growth for the province should remain fairly robust through the forecast period as cattle and beef import restrictions to the United States are lifted, potash production bounces back, and crop prices remain strong. Export growth is forecast at 12% for 2008, ahead of all other provinces.

Alberta's exports should grow 7% in 2007 and 4% in 2008. M&E, industrial goods and agri-food all posted solid increases this year. For 2008, gains in energy, forestry and M&E will contribute to the bottom line, albeit at a slower pace. Agri-food will be head and shoulders above all others though, as the stellar export growth experienced in 2007 is expected to continue next year. Industrial goods (metals, chemicals) will lose momentum, as prices soften in response to slower growth in foreign demand. **British Columbia**'s exports are set to contract by 2.4% in 2007. Declining values of wood products and natural gas exports have been the main source of weakness so far this year, with some softness also witnessed in coal and newsprint. A modest improvement of 1.7% is forecast for B.C.'s international shipments in 2008, although sales of industrial goods will be impacted by lower metal prices.

Table 4: CANADIAN MERCHANDISE EXPORT FORECAST BY PROVINCE

Provinces	CAD bn (2006)	% Share of Total Exports (2006)	Export Outlook (% Growth) 2006	2007 (f)	2008 (f)
Newfoundland & Labrador*	8.4	2.0	5.9	16.7	5.1
Prince Edward Island	0.8	0.2	1.8	4.8	1.9
Nova Scotia	5.0	1.2	-12.0	7.0	2.9
New Brunswick	10.4	2.5	-2.9	5.0	5.7
Quebec	69.1	16.8	3.2	2.7	-1.4
Ontario	177.4	43.1	-1.6	2.4	-0.7
Manitoba	10.9	2.6	12.3	15.1	7.3
Saskatchewan	15.8	3.9	13.4	14.6	11.7
Alberta	78.5	19.1	2.3	6.9	4.3
British Columbia	33.4	8.1	-2.0	-2.4	1.7
Territories	1.6	0.4	-2.9	-1.3	-0.8
Total Goods Exports	**411.3**	**100.0**	**0.7**	**4.1**	**1.5**

Source: EDC Economics. 2006 is actual data, while 2007 and 2008 are forecast.
NL includes EDC estimate for crude oil exports (*not included in national total from Statistics Canada).

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For the complete Fall 2007 Global Export Forecast visit
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Prepared by EDC Economics, Export Development Canada