BRITISH COLUMBIA

BC STATS

Ministry of
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Exports ◆ April 2003

- The value of BC origin exports is up 9% in the first four months of 2003 compared to the same period last year. Prices for energy commodities continue to fuel the export growth. The value of natural gas exports has sky-rocketed compared to the January to April period of 2002, increasing 209%. The value of electricity transmissions has jumped 113% year-to-date.

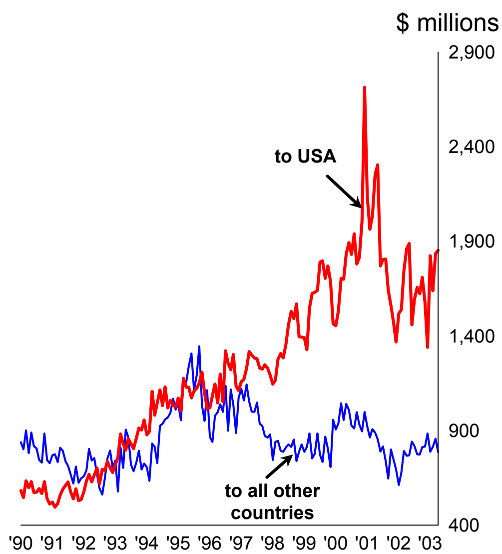
- The combined effects of the softwood lumber dispute, low prices and a rising Canadian dollar are seriously hurting softwood lumber exports. Year-to-date softwood lumber exports to the US are 36% lower compared to the first four months of 2002. In April, the implicit price of softwood lumber exported from BC (i.e., value divided by quantity) was at its lowest point since October 1992. Much of this is due to over-supply, which is a result of Canadian companies running near full capacity in an effort to bring down costs to mitigate against the duties payable to the United States.

- So far this year (to April), the value of mineral product exports has risen almost 14% compared to 2002. Unwrought aluminum shipments are up 16%, exports of copper ores and concentrates have jumped 30% and international sales of molybdenum ores and concentrates have increased 98%.

- Exports to the Pacific Rim have risen 20% year-to-date. Increases in Japan (+11%), Taiwan (+76%), South Korea (+27%) and China (+50%) have led the way. The value of exports to the European Union has fallen 3% year-to-date as shipments to the United Kingdom (-10%) and Germany (-18%) have dropped off.

- In May, the discovery of bovine spongiform encephalopathy (more commonly known as "mad cow disease") in a cow in Alberta prompted the United States to ban all imports of Canadian bovine and ruminant animal products. Total exports of live animals and meat products from BC fitting this description were approximately $122.4 million in 2002. This represents 0.5% of the value of all BC exports for the year.

High prices for energy products continue to drive growth in the value of BC origin exports

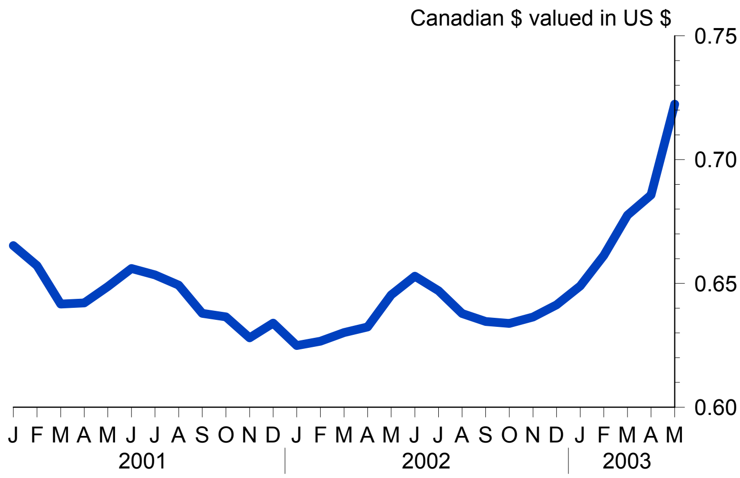


Exports and the Rising Dollar

The rapid appreciation of the Canadian dollar against its American counterpart has sparked concern for Canadian exporters. The rising dollar is a worry for exporters because: (a) where goods are priced in American dollars, it means the Canadian producers are receiving less for their goods when the revenue is converted to Canadian currency; and (b) where goods and services are priced in Canadian dollars, Canadian goods and services are more expensive to American buyers, so demand for goods and services from BC and the rest of Canada may fall, which could result in a significant decline in exports. Approximately 68% of BC origin goods exports and 87% of all Canadian commodity exports were shipped to the United States in 2002, which demonstrates the importance of that market.

In 2002, the US was the destination for 68% of BC's commodity exports and 87% of Canada's

The rapid appreciation of the Canadian dollar is causing concern for exporters



The rapid rise in the Canadian dollar from about 63 cents US in January to over 73 cents in just four months has exporters worried

While it is true that a higher-valued Canadian dollar will negatively affect the revenue of Canadian exporters, this does not necessarily mean that it will have a detrimental effect on their bottom line. Whether or not an exporter's net income is affected by the rising dollar depends on more than just its revenue stream. For example, it was recently reported that the sudden increase in the Canadian dollar has been a windfall for some BC forest companies.[1] The reason is that they have significant debt denominated in US dollars. This means that in the same way that American consumers have to pay more for Canadian products because it takes more American currency to buy Canadian dollars, these companies have to pay less in debt charges because it takes fewer Canadian dollars to buy American currency.

Those exporters with US-denominated debt may actually be benefiting from a higher Canadian dollar

[1] For example, see "Rising loonie helps debt but will hurt lumber," *Vancouver Sun*, May 8, 2003, p. F3.

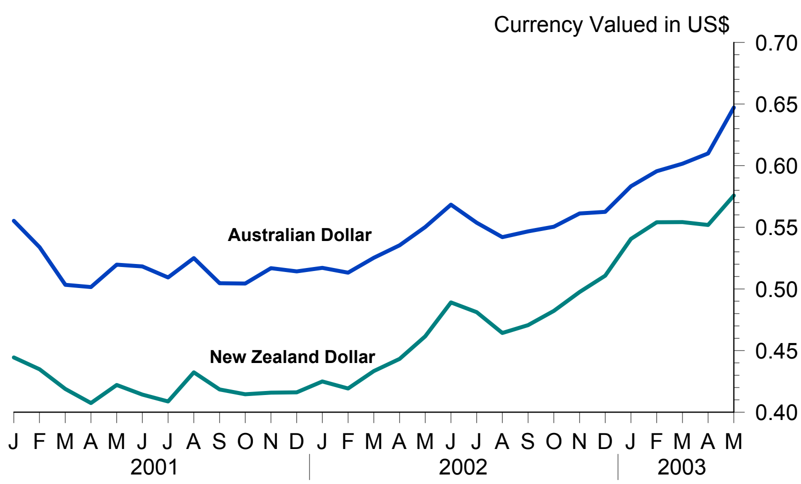
Exporters with significant material inputs imported from the US may achieve cost of production savings that will at least partially offset reduced sales revenues

Another possible benefit of the appreciating dollar is in terms of lowering the cost of production. In cases where manufacturing firms import significant amounts of the material inputs to their products, or machinery and equipment used in production, the cost savings from these inputs could at least partially offset the reduction in sales revenue.

Unfortunately, in British Columbia, much of what is exported is based on resource materials extracted within the province or is in the form of services, such as tourism. For these exports there is very little, if any, input material that is imported from elsewhere. For these exporters, unless they hold US-denominated debt, the rising dollar is problematic.

The service sector is possibly the most susceptible to severe fluctuations in the dollar. One example of a service sector that has benefited from a low Canadian dollar is the film industry. The price advantage afforded American filmmakers due to the favourable exchange rate has resulted in Canadian locations, particularly in BC and Ontario, attracting major film projects that may have otherwise been filmed in the United States, or in the case of some smaller budget projects, not been filmed at all. The strong growth in these so-called "runaway" productions has raised the ire of many of those working in the American film industry that believe American jobs are being exported to Canada.[2] The rising dollar may threaten some of this production in Canada, although it will likely have to appreciate considerably further to cause significant harm to the Canadian industry, particularly since the currencies of

Other currencies are appreciating against the US dollar as well



The Canadian dollar is not the only currency appreciating against the US dollar

[2] For some background on this issue, see the article '*Is "Runaway" Film Production in Canada Harming the U.S. Industry?*' in the February 2002 issue of *Exports*.

countries such as Australia and New Zealand, which are among Canada's main competitors in the film sector, are also appreciating against the US dollar. Other benefits of filming in Canada, such as qualified film crews, tax incentives, unique locations, common language and proximity to American post-production facilities should maintain the Canadian film industry's viability regardless of fluctuations in the exchange rate.

The tourism sector and other services could be hurt by a higher dollar

Tourism is another service sector that could suffer poorer earnings as a result of the rising dollar. After the terrorist attacks of 9/11 revenues from many tourism-related industries, particularly air travel, took a significant hit. For Canadian tourist destinations, the low Canadian dollar, combined with the relative proximity to the United States, helped attract many of those US tourists that had become reluctant to travel long distances. Perhaps even more importantly, the exchange rate convinced many Canadians to stay at home and travel within their own country. As the Canadian dollar rises and the spectre of terrorism begins to fade in people's minds, Canada could lose some of its lustre as a tourist destination for both Americans and Canadians alike and this could hurt tourism revenues.

Regression equations:

SE = 4904 – 5092 * ER+ 147 * T
GE= 5990 – 1587 * ER + 593 * T

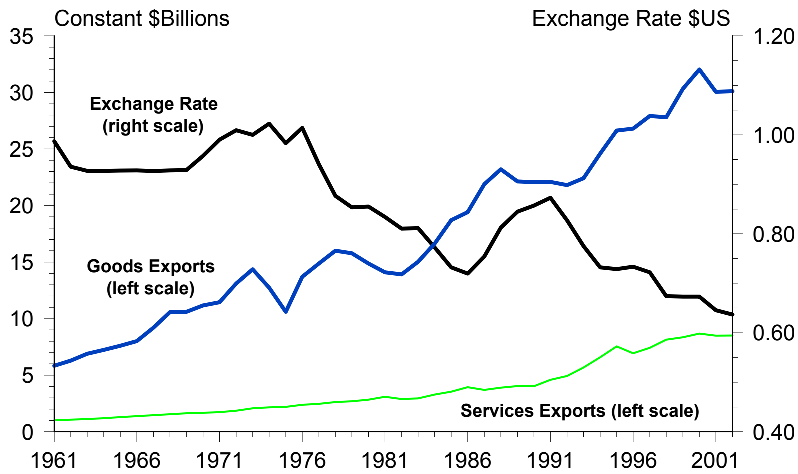
Where SE=Services Exports, GE=Goods Exports, ER=Exchange Rate, T=Time Trend
(See footnote for statistics)

There is some statistical evidence to support the idea that trade in services is more closely tied to fluctuations in the exchange rate. Based on a simple statistical regression of British Columbia service exports in *constant dollars* (i.e., removing the effects of inflation and exchange rates) against the exchange rate and a simple time trend, the exchange rate was shown to be a significant determinant of volume of service exports. On the other hand, for trade in goods, for BC, the exchange rate was not a significant determinant of export volumes. [3]

This does not necessarily imply that the exchange rate has no effect on BC commodity export volumes. It could mean that the general growth trend in exports dwarfed any exchange rate effects, or that the significance for some goods is concealed in the aggregate. For commodities like natural gas and electricity, for example, the exchange rate is unlikely to effect demand. Sales of these energy products are limited more by supply than demand. On the other hand, sales of machinery and equipment, for which there are more likely to be substitutes within the United States, are much more susceptible to exchange rate effects.

[3] The regression using annual exports of services from BC from 1961 to 2002 had an adjusted R-squared of 90% and t-values of –2.4 for the exchange rate variable (in $US) and 7.4 for the time trend variable. For goods exports, the R-squared was 96%, with t-values of –0.4 for the exchange rate and 14.8 for the trend variable.

Exports of both goods and services have grown steadily over the last few decades, but it is likely that only a portion of that growth was due to the falling dollar



Note: Export data presented here is from the Provincial Economic Accounts

There has been strong growth in goods and services exports over the last 40 years, but the value of the Canadian dollar is likely responsible for only a small portion of that growth

In the case of most resource products, prices are in American dollars, which means the changing exchange rate should not influence demand, but could have an effect on whether or not the supplier can afford to sell at that price. For instance, if a Canadian company has higher production costs than an American competitor, a low-valued Canadian dollar could still allow it to sell at the market rate (assuming most of its costs, such as labour and capital inputs, are in Canadian dollars). However, if the dollar appreciates enough, at some point the higher production costs will not be cancelled out by the exchange rate difference and the Canadian company will find itself in a situation where it can no longer afford to compete with the more efficient competitor.

For most resource sectors, rising commodity prices will help offset the higher Canadian dollar, at least to some extent, but for lumber producers it is a different story. The rising dollar combined with the ongoing dispute with the United States is creating a double whammy for British Columbia's lumber producers, or perhaps even a triple whammy. The higher value for the Canadian dollar means Canadian exporters are already taking a hit, because with their goods priced in US dollars, they are getting less when it is converted to Canadian currency. On top of that they have to pay a 27% duty on shipments to the US. To make matters even worse, Canadian mills have been trying to operate at full capacity to reduce costs in order to continue running in the face of these substantial duties, but this has resulted in an oversupply of wood on the market. Consequently, prices for lumber have fallen and are not likely to rise unless the excess supply is used up.

The rising dollar is exacerbating problems caused by the softwood lumber dispute

While it is beyond the scope of this report to determine with any precision the effect that the exchange rate has had on exports of goods and services from BC, it is likely that the overall effect is reasonably small and transitory, although for some industries, the effect may be significant. Service-producing industries, like tourism, may be more prone to suffering from a higher valued dollar and some goods-producing industries may be more affected than others. However, there are other factors, such as commodity prices, tariffs, global economic conditions, and so on that are likely far more important in terms of their effect on BC exports and BC exporters.

There are some disadvantages to a low Canadian dollar for exporters

In fact, there may be some disadvantages to exporters to having a low Canadian dollar. For example, when the dollar is low it is more expensive to import new cutting-edge technologies. This, combined with an "exchange rate subsidy," in effect, may cause Canadian companies to become complacent, allowing productivity to decline and investment in new capital to lag. The higher Canadian dollar may push these companies to become more efficient and accelerate investment in new technologies.

A higher value for the Canadian dollar may not in itself be a threat to the viability of Canadian exporters, but rather, it is the rate of appreciation that is causing problems. The rapid rise is not giving Canadian companies the time to adjust. If the rise occurred at a slower pace, Canadian exporters could make the necessary capital improvements and still maintain profitability.

Recent Feature Articles in British Columbia Origin Exports Release
Listed By Statistical Reference Date of Issue

NOTES

Countries Included Within World Regions:
(1) Western Europe: United Kingdom, Ireland, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland.
(2) Eastern Europe: other Europe, including all of Russia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, etc.
(3) South East Asia: Malaysia, Brunei Darussalam, Singapore, Myanmar, Kampuchea, Laos, Indonesia, Philippines, Thailand, Vietnam.
(4) Africa: continental Africa, excluding Ethiopia, Libya, Somalia, Sudan, Egypt.
(5) South America: continental South America from Colombia and Venezuela south to Chile and Argentina, including offshore islands, but not Caribbean.
(6) Central America and Caribbean: from Guatemala and Belize to Panama, plus Caribbean Islands.
(7) Pacific Rim (including Japan): Japan, Hong Kong, Malaysia, Brunei Darussalam, Singapore, Laos, Mongolia, China, Indonesia, North Korea, South Korea, Philippines, Macau, Taiwan, Thailand, Vietnam, Australia, Fiji, New Zealand.
(8) Pacific Rim: as above, but excluding Japan.
(9) Middle East: from Turkey and Iran south through the Arabian Peninsula. Excluding Afghanistan and Pakistan, but including Cyprus, Ethiopia, Egypt, Somalia, Sudan and Libya.

'Selected Value-added Wood Products' category includes prefabricated houses, doors, windows, furniture, moulding, siding, etc. It does not include panel products, shakes, shingles or any pulp and paper products.

Revisions
Statistics Canada revises trade data for the previous three data years with release of the December data. The revision number is indicated in the footer of the tables (e.g., Rev 1 is the first annual revision, etc., and Prelim indicates it is the first release of data to December for that year). In addition to annual revisions, Statistics Canada revises the data for the previous data year every quarter (indicated in the footer by Rev Q1, etc).

Service Offered for Detailed Trade Statistics
For B.C. government statistics users requiring more detailed information on exports or imports, a special report service is offered through the address below:

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This service is provided through the Trade Research and Inquiry Package (TRIP) computer reporting system. TRIP offers user-defined tabulations of export or import statistics for British Columbia, Canada, the United States and other countries. Tabulations can include information on commodities, countries, U.S. states, years, months, mode of transport, etc.