BC STATS
Service BC
Ministry of Labour and Citizens' Services

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Exports ◆ May 2007

- The value of BC commodity exports slipped 0.7% over the January to May period, compared to the first five months of 2006. A 4.3% drop in shipments to the United States was the main driver behind the decline, more than offsetting a 37.9% surge in exports to Mainland China.

- Exports of solid wood products continue to struggle, slumping 16.6% year-to-date compared to a year earlier. Fewer housing starts in the United States have reduced demand for building products, resulting in falling prices. Elsewhere in the forest sector, pulp exports continue to grow, jumping 33.6% year-to-date and helping propel overall pulp and paper shipments up 18.1%, despite an 11.7% slump in newsprint exports.

- The value of energy product exports is down 4.3% over the January to May period compared to the same five months in 2006, despite a 144.6% rise in the value of electricity exports as a result of both higher demand and higher prices. Exports of natural gas fell 6.0%, while coal shipments were 10.9% off last year's pace. For coal, the decline was entirely due to lower prices, as volumes shipped actually climbed 5.6%.

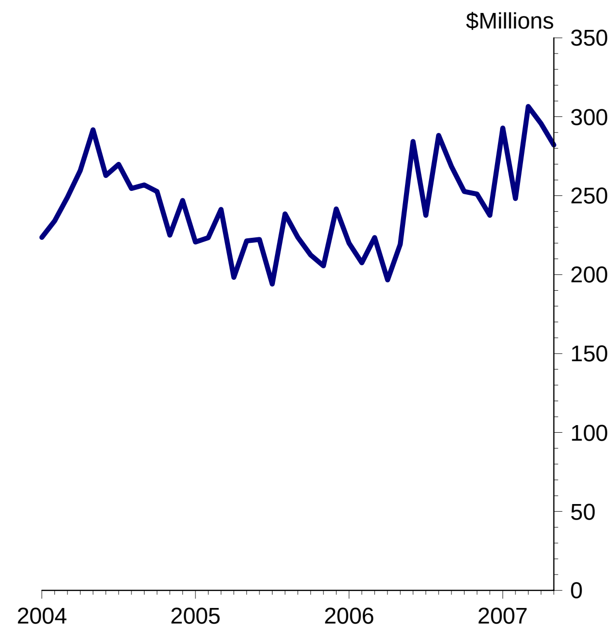
- There was a 14.3% jump in the value of exports of agriculture and food products, including a 69.9% jump in exports of fruit and nuts.

- Strong growth in shipments of unwrought zinc (+86.9%) helped drive up overall metallic mineral product exports 13.3%. Exports of copper ores and concentrates (+4.6%) and unwrought aluminum (+8.9%) also contributed to the increase. Exports of fabricated metal products have increased 3.3% year-to-date.

- International shipments of machinery and equipment are up 3.6% compared to the same period last year. Exports of motor vehicles and parts have climbed 2.6%, offsetting a similar 2.5% dip in shipments of scientific and photographic equipment. Shipments of electronic and communications equipment edged up 0.5%, while exports of other machinery and equipment grew 6.3%.

- BC origin exports of chemicals and chemical products have experienced strong growth in 2007, climbing 15.1% year-to-date, while shipments of plastics have gone in the opposite direction, falling 10.0%.

Pulp exports are trending up



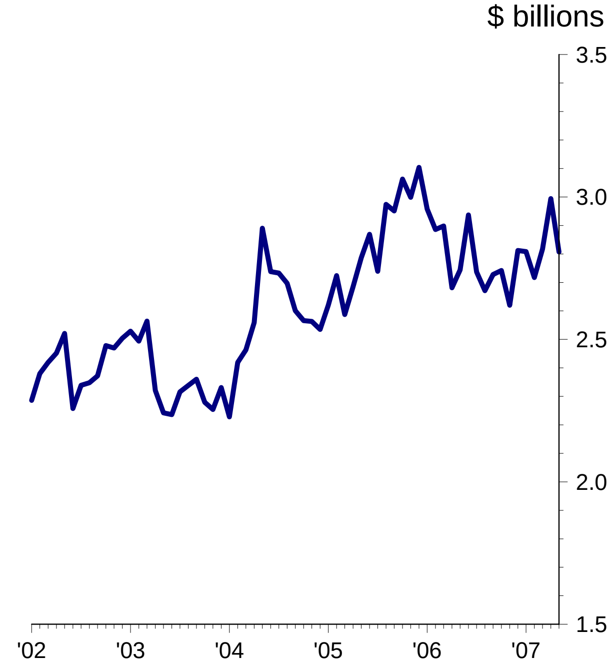
SEASONALLY ADJUSTED EXPORTS

Seasonal adjustment supplies a means of making month-to-month comparisons by removing the regular periodic seasonal fluctuations that occur. Variations from normal seasonal patterns are revealed in the seasonally adjusted data series.

- Exports fell 6.2% in May, losing all the ground gained a month earlier. Every major commodity category experienced a decline, with machinery, equipment and automobiles (-11.4%) and forestry products (-7.5%) seeing the largest drops.

- Exports to the US dipped 5.4%, while shipments to all other countries also fell, sliding 7.5%. The largest declines in exports to the US were for industrial and consumer goods (-8.0%) and energy products (-7.5%), while exports of machinery, equipment and automobiles to other countries plunged 32.9%.

Exports (adjusted for seasonality) lost all the ground gained a month earlier



BC Exports, Seasonally Adjusted ($Millions)

Month	Agriculture & Fish	Energy	Forest Products	Machinery& Equip, Auto	Industrial, Consumer	Total	Exports to USA
May 2005	190	559	1,155	362	520	2,786	1,763
Jun	214	606	1,121	364	564	2,869	1,808
Jul	174	725	1,006	363	470	2,739	1,832
Aug	201	781	1,064	370	558	2,974	1,850
Sep	189	786	1,039	358	578	2,951	1,823
Oct	194	869	1,144	371	485	3,063	2,061
Nov	203	692	1,149	378	578	2,999	2,017
Dec	192	791	1,177	386	559	3,104	1,978
Jan 2006	189	702	1,164	366	536	2,958	1,944
Feb	188	607	1,147	372	571	2,886	1,804
Mar	187	601	1,101	420	589	2,898	1,784
Apr	184	545	1,075	363	514	2,681	1,692
May	197	526	1,089	349	584	2,744	1,711
Jun	187	543	1,101	371	735	2,937	1,687
Jul	193	481	1,051	344	667	2,737	1,673
Aug	195	474	1,076	339	586	2,671	1,649
Sep	208	505	1,030	378	607	2,728	1,622
Oct	202	447	1,026	392	676	2,742	1,601
Nov	196	447	1,005	356	616	2,620	1,589
Dec	212	518	1,027	375	681	2,812	1,708
Jan 2007	215	515	1,096	364	618	2,808	1,728
Feb	210	582	996	372	556	2,717	1,696
Mar	217	559	1,063	381	597	2,817	1,731
Apr	207	617	1,124	382	664	2,994	1,765
May	200	597	1,039	338	632	2,807	1,670

Appreciating Dollar not Appreciated by Exporters

The rapid appreciation of the Canadian dollar is of increasing concern for Canadian exporters of goods and services. Since hitting a low point of just over 62 cents US in January 2002, the loonie has increased its value 46% compared to its American counterpart. Not only has the Canadian buck gained strength against the US greenback, but also against many of the currencies of its major trading partners. The Canadian dollar effective exchange rate index (CERI), a weighted average index produced by the Bank of Canada that compares the Canadian dollar to six others,[1] clearly demonstrates the relative strength of the loonie.

In the last few years, the Canadian dollar has appreciated significantly against the currencies of Canada's major trading partners

Source: Bank of Canada

[1] The six currencies are the US dollar, the Japanese yen, the UK pound, the European Union euro, the Chinese yuan and the Mexican peso.

Since the beginning of 2003, the CERI has risen by over 30 points, from 80.96 in January 2003 to 114.05 in June 2007 (+41%). Although the CERI is weighted heavily toward the US dollar, the Canadian dollar has also appreciated significantly against the yen, the yuan and the peso, while its relative value against the euro and the pound has fluctuated, remaining relatively flat, on average, over the last several years.

High dollar a problem for exporters

The sharp rise in the dollar has posed a significant challenge for Canadian exporters. With almost two-thirds of BC's commodity exports shipped to the United States and a substantial portion of exported services provided to Americans, BC exporters are vulnerable to changes in the value of the dollar. This is because goods and services priced in Canadian dollars will be more expensive for American buyers, which means they may look elsewhere for those products. Alternatively, for goods and services priced in US dollars, Canadian producers will receive less for them when the revenue is converted to Canadian currency.

A significant driver of Canada's currency appreciation is the movement in commodity prices. In general, when commodity prices are trending up or down, the Canadian dollar will follow due to the strong export orientation of Canada's economy. As a result, some exporters are cushioned from the rise in the dollar by concurrent hikes in prices of the commodities they are exporting. However, not all exporters are benefiting from higher prices for their goods. For example, lumber producers have seen the demand for their product slump in concert with a drop in housing starts in the United States and, as a result, prices too have fallen. For those lumber companies whose main client base is in the United States, the higher Canadian dollar is exacerbating an already bad situation. Exporters of manufactured goods are also hurt by the rise in the dollar's value and those manufacturers that allowed their productivity to stall when the low value of the dollar gave them an advantage over American competitors are now having to either play catch-up or get out of the game entirely. Some manufacturers are considering moving their operations out of Canada to a lower cost jurisdiction.

Silver linings?

There are some exporters that may benefit from a higher dollar, particularly if they have debt denominated in American currency. For those companies, even if they have been paying only the interest and have not touched the capital in the last few years, their debt load has been reduced significantly due to the appreciation of the loonie.

Another possible benefit to exporters of a higher-valued dollar is the fact that imports should be cheaper, which means that Canadian companies should be able to make capital improvements more cost-effectively and thereby improve productivity. Since much of the productivity-improving machinery and equipment is manufactured in the United States and a higher Canadian dollar means more buying power when converted to US currency, these imports will be less expensive and Canadian firms can reduce their production costs and become more competitive.

However, it appears that prices have been slow to fall in Canada in response to the dollar's appreciation and Canadians are not getting full value for the higher dollar. This is quite obvious for consumers buying books or greeting cards that have the price in both Canadian and US dollars. For example, the forthcoming new Harry Potter book can be purchased at a pre-order sale price of Cdn $22.50 on Amazon.ca, the Canadian version of the online retailer, but is US $17.99 for pre-orders on Amazon.com, the American site, which translates to Cdn $19.34 when using a 93 cent exchange rate conversion. Therefore, the Canadian price is 16% higher than it should be at a 93 cent exchange rate. For Canadians shopping for books in a retail store, rather than online, the discrepancy can be significantly greater.

This price discrepancy exists for other goods as well. Douglas Porter, writing in a BMO Capital Markets research article, suggested that "Retail prices in Canada have responded to the loonie's moonshot with all the speed and alacrity of a three-toed sloth on a hot summer's day."[2] He

[2] Porter, Douglas (June 15, 2007). "The Price is Wrong," *Focus*, BMO Capital Markets, p. 5.

gave examples ranging from magazines to automobiles where the Canadian price was significantly higher than the American equivalent and he suggested that the result of this discrepancy is that inflation in Canada is higher than it should be. Considering that a core inflation rate over the Bank of Canada's 2% target is the reason why the Bank is raising Canadian interest rates, and considering that the rise in rates will likely drive the dollar even higher, this is a serious problem for Canadian exporters. Not only are they not necessarily getting the benefit of cheaper imports of potentially productivity-improving goods, but they face additional appreciation of the dollar, further reducing their revenues.

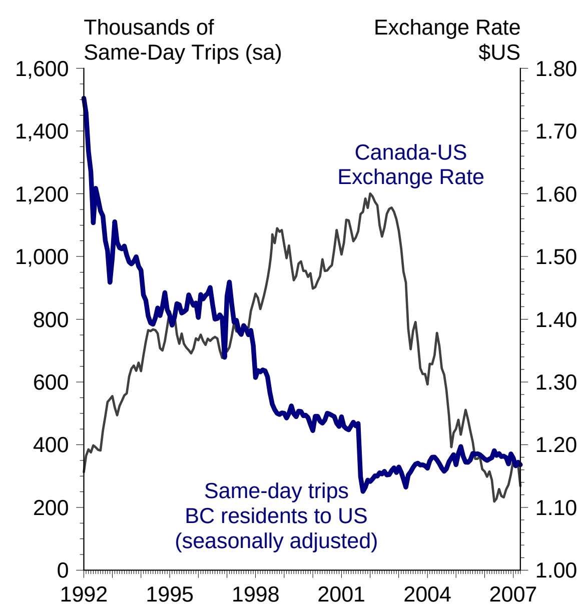
While Porter's analysis is based mainly on anecdotal pricing evidence, there is further support to suggest that prices in Canada are too high. The UBC Sauder School of Business produces a purchasing power parity (PPP) figure based on OECD PPP estimates and updated periodically to reflect the current exchange rate.[3] According to the latest PPP figures (July 10, 2007), the Canadian dollar is overvalued by between 13% and 14%.

The concept of PPP is that once an exchange rate is taken into account, goods should cost the same. Theoretically, if a good, say a book, costs significantly more in Canada, then more Canadians will shop in the United States for books. This should create more demand for the US dollar, which in turn will depress the value of the Canadian dollar. It should also result in less demand for books in Canada, which should reduce the price, while at the same time the increased demand for books in the US should raise the price of books there. Therefore, over time, the prices should equalize.

Why this hasn't yet occurred may be a combination of several things, including the rapidity of the loonie's ascent and general price stickiness for some products. Another factor may be the increasing hesitance of Canadians to travel to the United States, given the increased security hassles and the uncertainty surrounding identification requirements, not to mention the high price of gasoline that is likely discouraging some day trips.

Based on data for same-day trips to the United States, it appears that British Columbians have not embraced cross border shopping with the same zeal they did back in the early 1990s when the dollar was valued at around 85 cents US. Same-day trips to the United States are only slightly higher than they were in 2002 when the dollar hit it lowest point and well below levels seen in the early 1990s.

The rise of the Canadian dollar has not translated to a large increase in same-day trips from BC to the United States as it did in the 1990s



Sources: Statistics Canada and Bank of Canada

[3] See http://fx.sauder.ubc.ca/PPP.html

In addition to the border problems and the price of gas, other possible reasons for the failure of the high dollar to drive shoppers south to the United States may include the strong growth in the number of American retailers opening franchises in Canada as well as the increase in online shopping.

One of the reasons Canadians used to cross the border to shop was the greater variety offered by American retailers, but with the expansion of American chain stores operating in Canada, Canadians can now get most of those goods at home. The rise of e-commerce could be another thing keeping Canadians at home, as they can buy goods via their computer in the comfort of their own home. However, on-line purchases are not a practical choice for many goods and according to data from Statistics Canada, in 2006, even though retail firms almost doubled the value of goods and services sold online compared to 2005, it still only amounted to just over 1% of the total retail market.

While the combination of greater choice at home, border hassles and the high price of gasoline may be keeping Canadians at home for now, it is unlikely that this will continue to be the case if the dollar keeps appreciating against the American greenback and Canadian prices do not adjust accordingly. However, in the meantime, the BC tourism industry may see some of the loss in traffic of American tourists counteracted by an increase in Canadians staying at home.

Far fewer Americans have been visiting British Columbia in recent years, likely as a result not only of the increasingly unfavourable exchange rate, but also the confusion surrounding passport requirements. The decline has been only partially offset by an increase in visitors from countries other than the United States. Canada's tourism sector can take some solace in a recent Scotiabank survey of summer travel intentions, which reported that just over half (51%) of Canadians were planning to vacation within Canada this summer.[4]

Nevertheless, Canada's tourism sector and other service sector industries that depend largely on service exports, such as BC's film and television production industry, will be challenged to maintain revenues in the face of a dollar nearing par with its US counterpart. In the case of the film industry, there are already instances of productions moving south to regions such as Louisiana, which offers incentives better than those available in British Columbia.

Common Currency?

The challenges faced by exporters of goods and services with the Canadian dollar approaching parity with the US greenback have revived the talk of a common North American currency. David Dodge, governor of the Bank of Canada, suggested that a common currency for Canada, the United States and Mexico was a possibility in a recent speech in Chicago, with the caveat that some of the barriers between countries would have to be removed before it could happen.

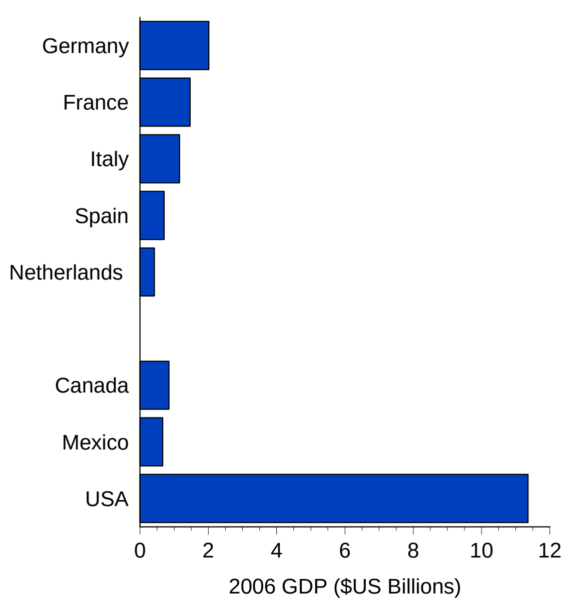
Proponents of the idea suggest that the benefits of a common currency include the elimination of the uncertainty surrounding exchange rate fluctuations, the consequent lowering of inflation rates as a result of the reduced risk and a reduction in transaction costs for trade between NAFTA partners. They point to the European Union and the euro as a successful

[4] Figure quoted in "Loon's strength no match for border hassles," *Vancouver Province*, June 28, 2007.

example and suggest that Canada could reap some of the same benefits.

However, there is one very large flaw in this line of argument. The composition of the European Union is substantially different from that of the North American Free Trade Agreement partners. In the EU, Germany has the largest economy, but Germany's GDP is not even larger than the sum of the next two largest economies, France and Italy (the United Kingdom is actually the second largest economy in the EU, but it has not adopted the euro as its currency). In contrast, the United States dominates the economy of the NAFTA region, with a GDP 7.5 times that of the other two members combined.

No one country dominates the EU in terms of economic output, whereas the United States economy dwarves that of Canada and Mexico



Source: OECD

If the United States were to agree to a common currency with Canada and Mexico, and this is a big if, it is fairly clear that monetary policy would be decided by the US with very little say from either of the other two interested parties. This would severely limit Canada's ability to deal with inflation and other economic fluctuations. Canada's economy differs significantly from that of the United States with a greater dependence on resource sectors, which means Canada tends to do better when commodity prices are high, while the opposite is the case in the United States. The current problem faced by the Bank of Canada of boom times in one region, such as oil-rich Alberta, at the same time another is flagging, such as the manufacturing sector in central Canada, will be multiplied when the additional economies of each of the American states and Mexico need to be considered. It is almost certain that the United States will look after their own interests first with little consideration for Canada and Mexico.

When the Canadian dollar was mired in the mid-sixty cent range just a few short years ago, the talk of a monetary union with the United States was a popular topic and now that the loonie is flirting with the possibility of reaching par with its American counterpart, it is once again a popular subject of discussion. This alone should make one question the wisdom of such a policy. If Canada and the United States had agreed to a common currency when the exchange rate was at its low point, the loonie would have been anchored at around 62 cents US. Canada would be inextricably tied to a weaker US economy with few fiscal options left to control inflation or economic growth.

Of course, all this presupposes that the United States would even be interested in having a common currency. A study from the University of California suggests that there is little likelihood of this and quotes a 2002 survey of public opinion in the US, taken from a C.D. Howe Institute report, that found that 84% of those surveyed did not want a common currency for North America.[5]

Given this, if Canada wanted to have a common currency with the United States, it would likely have to adopt the US dollar. Bank of Canada governer David Dodge may believe that a currency union is possible, but he certainly expressed his doubts a few years ago and was quite adamant with respect to the folly of the idea of pegging the loonie to the greenback: "Given the structure of our economy, for now and for as far into the future as I can see, the advantages of a flexible exchange rate, anchored by a domestic inflation target, clearly outweigh the benefits of a currency union. *And they will certainly always outweigh those of a peg*." [emphasis added][6] If Canada were to adopt the US dollar, it would have no say at all with regard to monetary policy. In effect, it would put its fate in the hands of the US Federal Reserve.

What happens next?

So where does that leave exporters and other Canadian businesses vulnerable to exchange rate fluctuations? The answer to this depends largely on the type of business and the situation it is in. For example, for manufacturers that have trouble competing because they are not as productive as their competitors, investment in capital and other productivity-improving measures could be the answer. For those that are already operating at peak efficiency, but are too small to contend with larger American competitors, perhaps a paradigm shift to serving niche markets could be the answer. For tourism operators, martketing campaigns to promote tourism in Canada to Canadians or toward another market other than the United States might help. For BC's film and television sector, perhaps it is time to concentrate on domestic productions rather than trying to keep up with the generous incentives offered by other provinces, states and countries around the world that are trying to capture the Hollywood market. For those that are crying "the sky is falling," they should remember that the dollar was once valued higher than the US dollar and Canadian companies managed to keep afloat.

[5] Cohen, Benjamin J. (2004) *North American Monetary Union: A United States Perspective*, University of California, p. 10.

[6] As quoted in: "No Common U.S.-Canadian currency: Dodge," *CBC News*, June 28, 2001. Retrieved June 21, 2007 from http://www.cbc.ca

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07-05 *Appreciating Dollar Not Appreciated by Exporters*
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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.

The **European Union** is the membership as of January 1, 2007: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom.

'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 BC government statistics users requiring more detailed information on exports or imports, a special report service is offered through the address below:

Dan Schrier
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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 BC, Canada, the United States and other countries. Tabulations can include information on commodities, countries, US states, years, months, mode of transport, etc.