BDC
Entrepreneurs first

economic LETTER

DECEMBER 2011 – **JANUARY** 2012

IS CANADA LESS DEPENDENT ON THE UNITED STATES THAN IT USED TO BE?

Canada weathered the last recession better than the United States. The decline in real GDP in Canada was less pronounced and, relatively speaking, Canada lost a lot fewer jobs than its neighbour and got them back quickly. Another major difference was that the collapse of the U.S. housing sector had no equivalent in Canada: yes, prices in this sector were down but the decline was insignificant compared to the drop in the United States. The strength of domestic demand and the rising price of oil helped kick start the Canadian economy, while the recovery south of the border is still fragile and will probably remain so until the housing sector recovers. How much can Canada grow if the United States continues to limp along? Are we still just as dependent on our neighbours?

Several indicators can help us answer this question. First, our export markets are better diversified than before. The share of Canadian exports going to the United States declined from 87% in 2001 to 75% in 2010, while the share going to Europe and Asia almost doubled over the same period. The number of Canadian establishments that export to countries other than the United States has jumped over the past decade, from 29% of exporters in 2001 to 43% in 2009. And the establishments that export exclusively to countries other than the United States rose from 12% to 20% over the same period.

Provincially, the proportion of British Columbia's exports to the United States shrank in the past decade, from 70% in 2001 to 45% in 2010 (see table), as it exported more to Asian countries. Because of its geographic location and abundance of natural resources, the province benefited from the development of China in particular, where the demand for raw materials skyrocketed. Quebec also significantly reduced the proportion of its exports to the United States, due to the diversity of its export products. On the other hand, the United States remains the main destination for provinces whose main exports are energy products, like Newfoundland and Labrador, New Brunswick and Alberta. However, these provinces are more vulnerable to fluctuations in the price of oil, which is determined globally, than to the slowdown in the U.S. economy.

In addition, the stronger Canadian dollar and greater competition from emerging markets led to substantial shrinkage in the Canadian manufacturing sector, whose share of total production declined from 18% in 2000 to 13% in 2010. Since the manufacturing sector has the highest percentage of all exporting ▼

BDC's Monthly Economic Letter is produced by the Strategy and Corporate Development department and is based on a variety of public sources of economic data. The information in this letter is drawn from data released prior to December 3. Reliance on and use of this information is the reader's responsibility.

establishments (41%) and the highest value and volume of exports, the importance of exports in economic production also declined: the weight of exports in real GDP went down from 44% in 2000 to 34% in 2010.

From these indicators we can conclude that, overall, Canada is less dependent on the United States than it was in the early 2000s. This trend should continue over the coming years. For the time being, however, Uncle Sam is still our biggest trading partner by far, absorbing three quarters of our exports. Therefore, if the U.S. recovery does not get stronger, there is no question that the Canadian economy will suffer.

Share of exports going to the United States (%)

	2001	2005	2010
British Columbia	70	65	45
Saskatchewan	59	70	63
Manitoba	79	75	64
Quebec	85	81	68
Newfoundland and Labrador	64	73	70
Prince Edward Island	89	80	72
Nova Scotia	83	80	74
Canada	87	84	75
Ontario	93	89	80
Alberta	89	89	86
New Brunswick	89	91	87

Source: Industry Canada

CANADA

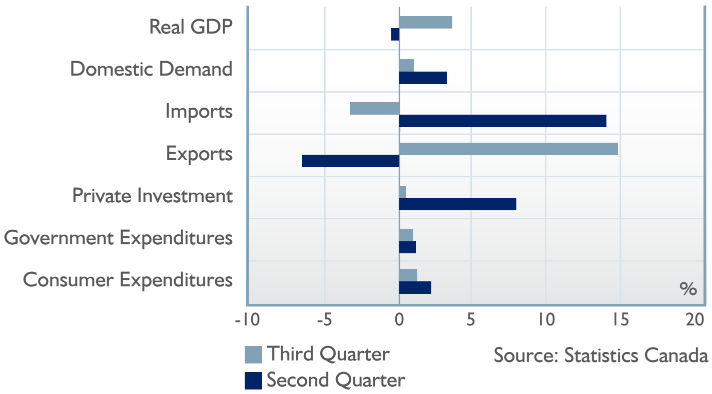
Back

National accounts data confirm, as expected, that the decline in production in the second quarter was only temporary. In fact, real GDP rebounded in the third quarter, as strong exports more than made up the ground lost in the previous quarter. That being said, real GDP growth since the beginning of the year is still moderate and likely to remain so in the coming quarters. Also, employment fell for the second month in a row. However, this decline was limited and concentrated in just one province, so it could well be reversed next month.

Real GDP rebounds

After dipping 0.5% in the second quarter, real GDP rebounded in the third, at an annual pace of 3.5%. Export growth, which was disrupted by specific events in the second quarter–like the forest fires in Alberta, which slowed oil production, and the tsunami in Japan, which caused a drop in production of vehicles and auto parts–had been expected to resume in the third quarter, which it did. Exports grew 14.4% while imports declined 3.2%. Consumer and government spending increased but at a slightly slower pace than in the previous quarter. Private investment, on the other hand, barely changed in the third quarter. A strong increase in investment in residential construction was cancelled out by the decline in investment in machinery and equipment, following particularly high growth in the latter in the second quarter. On average, real GDP grew 1.5% in the second and third quarters which, by and large, is relatively moderate growth and in line with forecasters' expectations.

Growth in Real GDP and its Components



Source: Statistics Canada

Employment down for the second time

Employment was down for the second month in a row in November but the decline was less pronounced, with 18,600 jobs being shed versus 54,000 in October. A gain of 34,600 full-time jobs was more than offset by the loss of 53,300 part-time jobs. The unemployment rate edged up 0.1 percentage points to 7.4%. Much of the decline in employment in November occurred in Quebec, where the loss of 30,500 jobs wiped out all of the previous year's gains. The losses occurred in the service sector, especially retail and wholesale trade, but it would not be surprising to see things turn around in December as the holiday season moves into high gear.

Monthly Change in Employment

Source: Statistics Canada

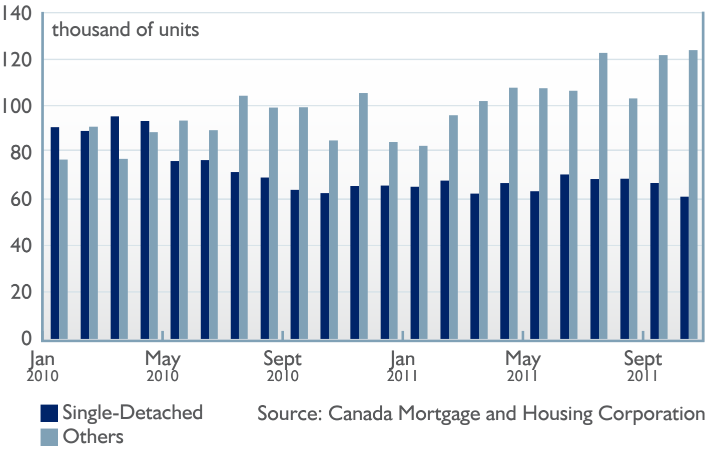
Trade balance goes from a deficit to a surplus

A 4.2% rise in exports combined with a 0.3% drop in imports moved the trade balance from a deficit of $487 million in August to a $1.2 billion surplus in September. Exports increased in most sectors, due largely to price increases, since volumes were up only 0.3%. Imports declined mainly in the machinery and equipment and automotive product sectors. This was entirely attributable to lower volumes, since prices rose.

Housing starts down slightly but still high

The number of housing starts edged down from 208,800 units in September to 207,600 in October. The decline was due to fewer single family home starts in urban areas (-9.0% in October versus September) while multiple-unit housing starts rose slightly by 1.7% after surging 18.1% in September. CMHC continues to predict that the growth in housing starts will slow in the coming months, coming more into line with demographic changes in Canada.

Housing starts in Urban Centres



Source: Canada Mortgage and Housing Corporation

Corporate profits should stabilize

The Conference Board's Leading Indicator of Industry Profitability (LIIP) fell in October for the fourth consecutive month, but at a rate close to zero (-0.06%), which suggests that the trend could soon be reversed. As in September, 26 of the 49 industries covered by the Indicator posted declines in October. However, many of the declines were counterbalanced by large increases elsewhere, especially in some manufacturing industries. While the previous month's results pointed to weaker corporate profits in the next 3 to 6 months, the October data indicate that profits will fall until the end of 2011 and then stagnate in early 2012. The business financial statistics published by Statistics Canada show a small decline of 0.5% in the operating profits of Canadian companies in the third quarter compared to the previous quarter, to stand at $63 billion, which is less than before the recession. ■

★ UNITED STATES

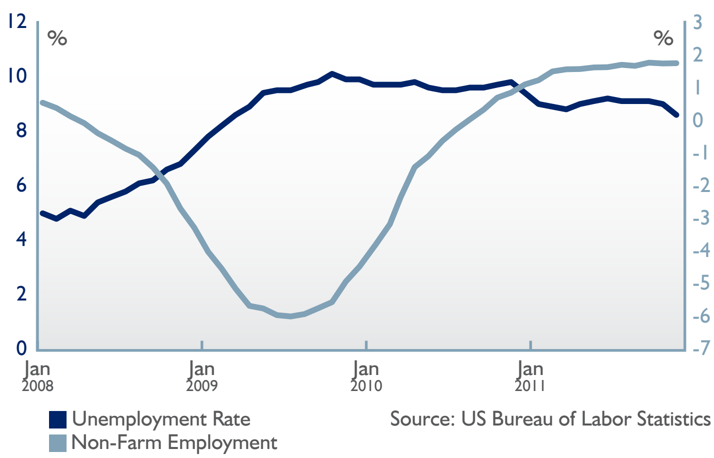
Back

The most recent data indicate that the recovery is strengthening. Employment continues to grow and the unemployment rate is falling gradually. Although the housing market is a long way from being out of the woods, at least it seems to be stabilizing. All of which is improving consumer confidence, which is essential in achieving a sustainable economic recovery.

Employment continues to grow

Job numbers showed a gain of 120,000 in November, as 140,000 positions were created in the private sector while the public sector lost 20,000. The unemployment rate edged down 0.4 percentage points to 8.6%, its lowest level since March 2009. The private sector has added an average of 156,000 jobs per month since the beginning of 2011. The labour market is slowly but surely recovering from the recession, which should strengthen economic growth in the coming months. ▼

Annual Change in Employment and Unemployment Rate



Source: US Bureau of Labor Statistics

Housing market stable

Housing starts, which were up 7.7% in September from the previous month, dipped only 0.3% in October. Single family home starts posted a 3.9% increase while multiple-unit housing starts were down 13.3%. The value of building permits rose 10.9% in October, which augurs well for housing starts in November. Also, after falling 3.0% in September, sales of existing homes rose 1.4% in October. At the current pace of sales, the inventory of unsold homes stands at 8.0 months. According to the National Association of Realtors, the resale market is stagnating despite numerous factors that should boost sales, such as rising employment, higher rents and the affordability of homes (low prices and low mortgage rates), because credit conditions are still restrictive.

Consumer confidence rebounds

The growth in real consumer spending slowed from 0.5% in September to a meager 0.1% in October. However, the U.S. Conference Board's Consumer Confidence Index surged 15.1 points in November. The Present Situation Index increased from 27.1 to 38.3 while the Expectations Index went up from 50.0 to 67.8. Consumers' apprehension with regard to business conditions and job and income prospects has eased considerably, which suggests that consumer spending could pick up speed in the coming months. ■

INTEREST RATES

Back

Key interest rate should not change until 2013

In its next monetary policy decision on December 8, the Bank of Canada will certainly leave the key interest rate at 1.0%. In a recent speech the governor of the central bank admitted that the latest data indicate that economic growth in the second half of the year will be stronger than predicted in the October Monetary Policy Report. However, the Bank does not expect inflationary pressures to intensify for quite some time. This opinion is shared by most forecasters, since the Consensus indicates that the key interest rate should remain constant until the end of 2012. Also, the Federal Reserve's key interest rate should remain unchanged until mid-2013, which means that the gap between Canadian and U.S. key interest rates should also remain stable until the end of next year. ■

OIL AND THE LOONIE

Back

Price of oil up again and Canadian dollar still volatile

Many factors have contributed to the recent rise in the price of oil: increased confidence among American consumers, new optimism about the European crisis fueled by rumours of an IMF plan to help Italy, and rising tensions between western countries and Iran, which is suspected of trying to develop nuclear weapons. Iran is the second largest producer in OPEC and it also controls the Strait of Hormuz, through which nearly 40% of global maritime shipments of oil pass. In addition, the Canadian dollar continued to fluctuate in recent weeks. ■

Crude Oil Price and Canada-U.S. Exchange Rate

BUSINESS CREDIT CONDITIONS

Back

Business credit down but still affordable

Business credit from chartered banks dropped 9.0% in October from the previous month. This drop was entirely due to short-term credit, which was down 11.3%, while long-term credit rose 6.5%. For the first time in nearly two years, the annual growth in business credit from chartered banks declined, from 8.3% in September to 7.4% in October. However, at 3.5%, the effective business interest rate, which is a weighted average of bank and market interest rates for new lending to non-financial businesses, is still affordable.

Effective Business Interest Rate

Source: Bank of Canada

KEY INDICATORS – CANADA

Back

Key indicators – Canada	Historical				2011				Latest		Forecasts	
	2007	2008	2009	2010	Q1	Q2	Q3	Q4			2011	2012
Real GDP (% growth)	2.2	0.7	-2.8	3.2	3.5	-0.5	3.5		Sep	0.2	2.3	2.0
Machinery and Equipment Expenditures (% growth)	4.2	-0.5	-19.5	11.8	14.5	32.7	-11.0				16.3	7.4
Pre-Tax Corporate Profits (% growth)	1.9	11.0	-33.1	21.2	20.5	-7.8	18.1				12.3	5.1
Industrial Production (% growth)	-0.5	-3.1	-9.5	4.9	7.0	-3.8	7.3		Sep	0.6	3.1	2.9
Industrial Product Prices (% growth)	1.5	4.3	-3.5	1.0	9.6	5.4	-0.3		Oct	-0.1	4.3	2.4
Non-Residential Construction (% growth)	2.3	7.9	-22.2	2.8	10.3	-0.9	4.4					
Housing Starts (' 000 units)	229	212	149	192	178	192	205		Oct	208	190	180
Personal Expenditures (% growth)	4.6	3.0	0.4	3.3	-0.1	2.1	1.2				1.9	2.0
Consumer Price (% growth)	2.1	2.4	0.3	1.8	3.6	3.1	1.1		Oct	0.2	2.8	2.0
Employment (% growth)	2.4	1.7	-1.6	1.4	2.4	2.0	1.2		Nov	-0.1		
Unemployment Rate (%)	6.0	6.1	8.3	-3.1	7.8	7.5	7.2		Nov	7.4	7.4	7.2
SMEs Confidence Index (CFIB)	67.2	56.1	57.7	66.7	69.2	68.0	64.2		Oct	63.6		
Manufacturers Confidence Index (CFIB)	68.8	52.7	56.0	68.6	72.6	71.0	63.5		Oct	61.7		

Sources: Statistics Canada, Consensus Economics and Canadian Federation of Independent Business. Annual growth, quarterly growth at annual rate and month-over-month growth.