

# economic LETTER

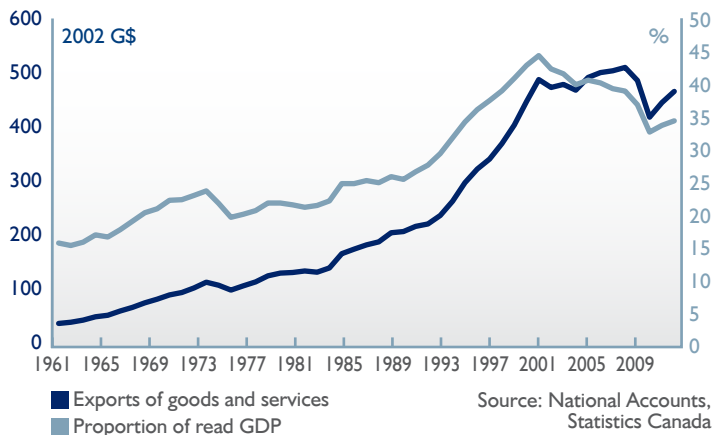
DECEMBER 2012



## SLOWDOWN IN INTERNATIONAL TRADE: HAS INTERPROVINCIAL TRADE MADE UP FOR IT?

Canada has always been a country open to the world, but it has become increasingly so over the years. In 1960, exports accounted for 15% of the country's real GDP, and that proportion nearly doubled in the space of 30 years, reaching 27% in 1990. The Free Trade Agreement between Canada and the United States, signed in 1987, and the North American Free Trade Agreement, adopted in 1994, sent Canadian exports soaring in the decade that followed: in 2000, their share of real GDP reached an unprecedented peak of 44% (Graph 1).

**Graph 1: Canadian exports of goods and services and their proportion of GDP**



However, since the beginning of the 2000s, this trend has reversed course. Canada's competitiveness on the international market has eroded due to intensifying competition from emerging countries, particularly China, and from the substantial appreciation of the Canadian dollar against the U.S. dollar. After growing steadily since 1960, the volume of exports stabilized from the early 2000s onwards, and then dropped in 2009, at the time of the global recession. Indeed, it would certainly have diminished well before 2009 if it had not been supported by the American economy, which held firm until the end of 2008. As a result, the share of Canadian GDP claimed by exports fell from 44% in 2000 to 34% in 2011. ▼

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- > The trade deficit narrows
- > Housing starts pull back, the real estate market slows
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### Interest rates

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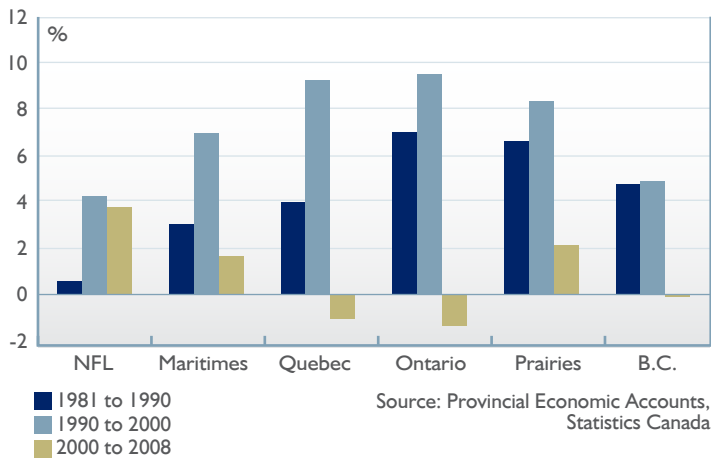
### Key indicators

BDC's Monthly Economic Letter is prepared by the Economic Analysis team from Marketing and Public Affairs 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 8. Reliance on and use of this information is the reader's responsibility.

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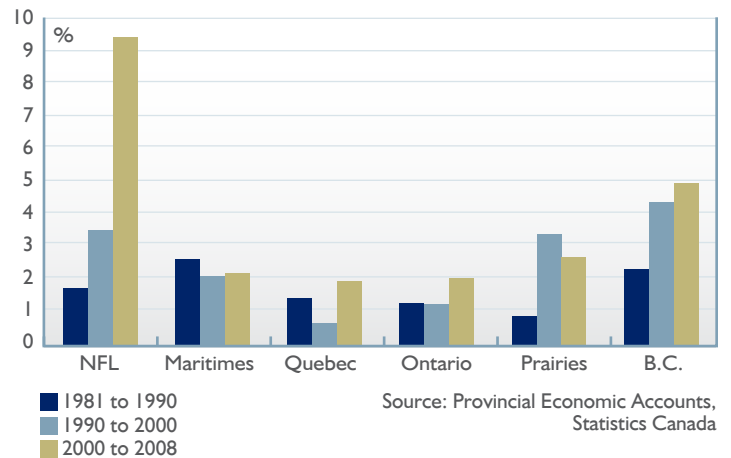
International exports have not followed the same trend in all parts of Canada since 2000. Ontario and Quebec, the provinces where the manufacturing sector carries more weight and which were therefore most vulnerable to foreign competition, recorded the largest downturns; meanwhile, the provinces that produce oil and minerals, like Newfoundland and Labrador, Alberta and Saskatchewan, benefited from strong foreign demand for those products and their international exports kept increasing, albeit at a slower pace. So, between 2000 and 2008, international exports dropped by 1.0% and 1.4% per year, on average, in Quebec and in Ontario, while those of Newfoundland and Labrador and the Prairie provinces climbed by 3.8% and 2.2% per year, on average (Graph 2).

**Graph 2: International exports by region**  
(average annual variations)



During this period, trade between the provinces, however, accelerated in all regions except for the Prairie provinces (Graph 3). In the case of Newfoundland and Labrador, this is due to the sale of a considerable share of the province's oil, production of which started at the end of the 1990s, to the country's eastern and central provinces. Meanwhile, the Maritimes, Quebec, Ontario and British Columbia benefited from the economic boom in the Prairie provinces, which greatly stimulated demand for their goods, and for their services in particular. Having said that, growth in sales from the central provinces to other Canadian provinces was relatively modest, despite its acceleration, reaching just 2% per year on average between 2000 and 2008. It did not manage to offset the decline in international exports: taken together, Ontario and Quebec saw the volume of such exports melt by \$33 billion over this period, while they gained \$22.5 billion in interprovincial trade; this produced a deficit of \$10.7 billion, recorded mainly by Ontario. In short, interprovincial trade did not make up for the slump in international trade in those two provinces, although it did soften the blow. ■

**Graph 3: Interprovincial exports by region**  
(average annual variations)



<sup>1</sup> We calculated the average annual growth up to 2008 only, in order to avoid including, in our analysis, the drop in international exports caused by the global recession of 2009, as opposed to that caused by the appreciation of the Canadian dollar or the increase in foreign competition.  
<sup>2</sup> In constant 2002 dollars.

The November jobs numbers show that conditions are still favourable in the labour market, which leads us to believe that the slowdown in real GDP growth that was observed in the third quarter was a temporary phenomenon. In order for real GDP growth to reach 2.0% in 2012, as expected by the Consensus, it would take just 2.0% growth in the fourth quarter, in terms of annual rate, which is entirely attainable.

### Real GDP growth decelerates

Real GDP growth slowed down in the third quarter of 2012 compared with the previous quarter, sliding from 1.7% to a mere 0.6% (Graph). Growth in household consumer spending accelerated, as did government spending, and investment in corporate inventories rose. The other components made a negative contribution to real GDP growth: exports posted their largest drop since 2009, imports rose at nearly the same pace as in the previous quarter, and business investment declined for the first time since the recession. This slowdown in growth should be only temporary: the composite leading indicator does not point towards a recession, and both household and business confidence are heading up.

**Real GDP Growth**  
(2007 Q3 to 2012 Q3)

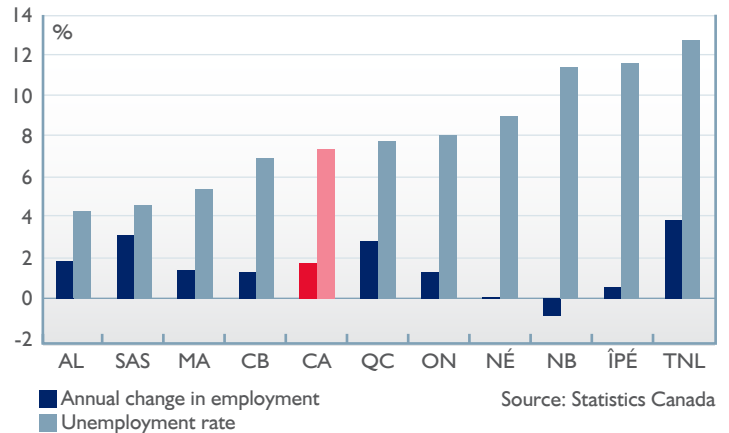


### Employment resumes its upwards trend

After a pause in October, employment resumed its upwards trend in November: 59,300 jobs were created during the month, the great majority of them (55,200) being full-time positions. The unemployment rate was down by 0.2%, coming in at 7.2%. Employment fell in the goods sector in November, particularly in construction and manufacturing, but it rose sharply in the services sector, especially in accommodation and food

services, trade, and professional, scientific and technical services. In the regions, the largest gains were made in Ontario, Quebec and Alberta. Alberta's unemployment rate dropped from 4.5% in October to 4.2% in November, the lowest in Canada (Graph).

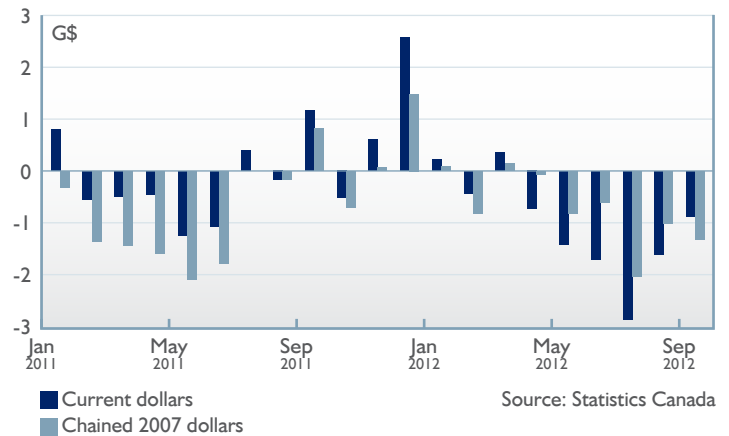
**Unemployment Rate and Employment Growth, by province**  
(November 2012)



### The trade deficit narrows

Exports increased by 1.9% from August to September, while imports held steady, with the result that the trade deficit narrowed from \$1.5 billion in August to \$826 million in September. The rise in exports is due to higher prices, in particular for crude oil, while on the imports side, lower prices were offset by larger volumes. In short, net exports rose in value, but declined in real terms (Graph). The trade surplus with the United States expanded in September, while the trade deficit with the other countries shrank. ▼

**Net Exports**



## Housing starts pull back, the real estate market slows

Housing starts tumbled from September to October, from 223,995 units to 204,107 units. The decline was 7.6% in the single-family homes segment and 11.4% in the multiple-units segment. Although housing starts were down in all parts of the country, it was the Atlantic provinces, Quebec and the Prairie provinces that recorded the largest slumps. The October numbers are consistent with the forecasts of the Canada Mortgage and Housing Corporation, which is calling for a slowdown in residential building activity between now and the end of 2012 and in 2013. As for sales of existing homes, after five straight months of contraction, they rose by 2.5% in September compared with the previous month, but were down by 15.1% compared with the same month of last year.

## ★ UNITED STATES

The U.S. economy is recovering: employment is advancing at a good clip, and the unemployment rate is falling; the housing market is still precarious but is gradually gaining strength. We can only hope that the Democrats and Republicans will quickly find some common ground on the budget, in order to avoid compromising the economic recovery that seems to be on the verge of taking hold.

### Real GDP growth is revised upwards

Third-quarter real GDP growth has been revised upwards, from 2.0% to 2.7% (quarterly variation, annual rate). This number reflects upwards revisions to private investment in business inventories and exports, which were partly offset by downwards revisions to consumer spending and private, non-residential investment.

### Employment keeps expanding

Employment continued its upwards trend with a gain of 146,000 jobs in November. After slowing down over the summer, job growth has resumed a more sustained pace: on average, 158,000 jobs per month have been created since July. Growth since the start of the year has reached 1.3%, but it has been stronger in the service sector (1.7%) than in the goods sector (0.7%). It should be noted that since the recession ended, there has been no job creation in the construction sector, and very little in manufacturing (Graph). As for the unemployment rate, it retreated further in November to reach 7.7%, its lowest point since December 2008, when it was 7.3%. But it is still high compared with the average of 4.6% that was recorded back in 2007.

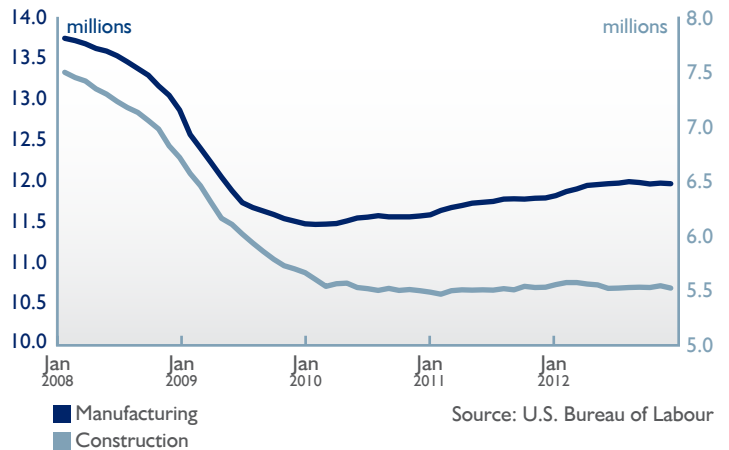
The number of new listings climbed by 6.5% in September, which helped to further balance the resale market. The Canadian Real Estate Association believes that the market will keep sputtering from now until the end of the year, due to the tightening of mortgage rules.

### The leading indicator still points towards growth

The Macdonald-Laurier Institute's leading indicator edged up for the second straight month in October, by 0.2%. The housing index is down, but growth in durable goods orders and hours worked in the manufacturing sector, along with the upturn in stock market indexes, broadly compensate for that drop. The composite indicator heralds slow but steady growth in the Canadian economy in the next six months. ■

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### Employment : Construction and Manufacturing (January 2008 to November 2012)



### Housing starts and home sales advance

After a 15.1% surge in monthly growth in September, housing starts sputtered by 3.6% in October. The increase is entirely attributable to starts of multiple-unit projects, which soared by 10.0%, since starts of single-family homes were practically static (-0.2%). As for home sales, they edged up by 2.1% in October compared with the previous month, which puts them 10.9% higher than they were in October 2011. The median price of homes continued to rise, and inventories declined further. At the current pace of sales, it would take 5.2 months to sell off the inventory of homes on the market. This is the lowest level of inventory since February 2006. ▼

## Business confidence dips, but consumer confidence continues its upwards trend

The Institute for Supply Management's Purchasing Managers' Index fell below the 50% mark in November, signalling a contraction in manufacturing production (Graph). At 49.5%, the index stands well above the critical threshold of 42.6%, which signifies a downturn in overall economic growth. The uncertainty surrounding the U.S. budget is having a negative effect on business confidence: many respondents to the Institute's survey said they were concerned about whether the discussions between the Democrats and the Republicans would produce a solution by January; if not, the country would be subjected to a forced austerity plan. Meanwhile, the Conference Board's Consumer Confidence Index rose again, from 73.1 in October to 73.7 in November. This means that it has reached its highest level since February 2008, when it stood at 76.4. In recent months, consumers have shown increasing optimism about the current and future state of the job market, and this impression has given a real boost to their confidence. ■

ISM'S Purchasing Manager Index  
(January 2007 to November 2012)



Source: Statistics Canada

## INTEREST RATES

### The key interest rate remains low and stable

Forecasters were not surprised by the Bank of Canada's decision to leave its trendsetting interest rate unchanged at the level where it has been sitting since September 2010, i.e. 1.0%. The central bank partly attributes the weakness of Canada's real GDP growth in the third quarter to "transitory disruptions in the energy sector" and expects growth

to pick up steam in 2013. The Bank reiterates in its press release that "some modest withdrawal of monetary policy stimulus will likely be required, consistent with achieving the 2 per cent inflation target," but the vast majority of analysts do not foresee any key interest rate hike before the last quarter of 2013. ■

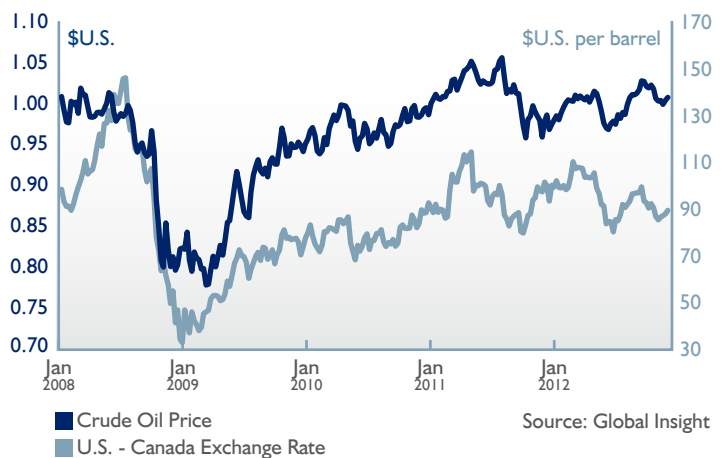
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## OIL AND THE LOONIE

### The price of oil and the Canadian exchange rate stabilize

After losing ground for reasons linked with global demand (recession in Europe, weakness in the U.S. economy) and supply (expanding inventory in the United States), the price of crude oil recently stabilized. The upwards revision of American real GDP growth in the third quarter sent the price of oil climbing last week, but the dip by the Purchasing Managers' Index for the manufacturing sector below the 50 mark pushed it back down. American economic conditions have great influence on crude oil prices, since the United States is the largest consumer of that commodity. The ongoing geopolitical tensions in the Middle East are continuing to put upwards pressure on the price of crude. The combination of all these factors has resulted in a stabilization of prices in recent weeks. The Canadian dollar has held steady in recent weeks, at parity with the U.S. dollar. ■

Price of Oil and the Canada – U.S. Exchange Rate



Source: Global Insight

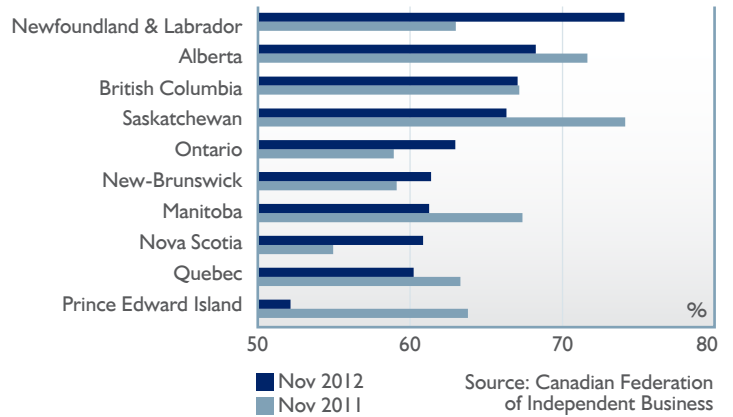
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## Business confidence falls back

The sharp rise in the CFIB's Business Barometer in October proved only temporary: the index, which had soared by 62.0% in September and by 65.6% in October, slipped back to 62.9% in November. However, it is still higher than the average of 61.0% that was recorded this past summer. While business leaders in the Western provinces are still among the most optimistic in the country, they are less so than a year ago (Graph). The natural resources sector shows the lowest level of optimism: the index dropped below the 50 mark in November, its lowest point since June 2009. On the other hand, business hiring outlooks are very positive: 22% of survey respondents plan to expand their full-time staff in the next three or four months, which constitutes a record. ■

## Business Barometer Index



## BUSINESS CREDIT CONDITIONS

## Bank credit to businesses escalates

Short-term credit granted to businesses by the chartered banks rose by 3.6% in October compared with the previous month, while long-term credit expanded by 6.8%. Over a 12-month horizon, growth in total bank credit granted to businesses stood at 11.6% in October. The effective interest rate for businesses (a weighted-average borrowing rate for new lending to non-financial businesses, estimated as a function of bank and market interest rates) is still low: it was 3.2% at the end of November (Graph). ■

## Effective Business Interest Rate



Key indicators – Canada	Historical				2012				Latest	Forecasts		
	2008	2009	2010	2011	Q1	Q2	Q3	Q4		2012	2013	
Real GDP (% growth)	1.1	-2.8	3.2	2.6	1.7	1.7	0.6		Sep	0.0	2.0	2.0
Machinery and Equipment Expenditures (% growth)	0.1	-20.4	13.7	10.7	4.1	1.6	0.2				3.2	5.8
Pre-Tax Corporate Profits (% growth)	11.0	-33.1	21.2	15.4	-23.7	-17.2	4.4				0.0	3.9
Industrial Production (% growth)	-3.1	-9.5	4.9	3.5	-1.5	1.0	-2.9		Sep	-0.2	1.9	3.1
Industrial Product Prices (% growth)	4.3	-3.5	1.0	4.6	0.9	0.8	-2.7		Oct	-0.1	0.7	1.6
Non-Residential Construction (% growth)	7.8	-18.6	15.0	10.2	9.0	14.2	-4.4					
Housing Starts (' 000 units)	211	148	191	193	206	231	222		Nov	196	212	184
Personal Expenditures (% growth)	2.9	0.1	3.5	2.4	1.1	0.4	3.1				1.7	2.0
Consumer Price (% growth)	2.4	0.3	1.8	2.9	2.1	0.1	0.1		Oct	0.2	1.8	1.9
Employment (% growth)	1.7	-1.6	1.4	1.5	0.9	2.8	0.4		Nov	0.3		
Unemployment Rate (%)	6.1	8.3	8.0	7.5	7.4	7.3	7.3		Nov	7.2	7.3	7.2
SMEs Confidence Index (CFIB)	56.1	57.7	66.7	66.4	66.3	64.4	61.0		Nov	62.9		
Manufacturers Confidence Index (CFIB)	52.7	56.0	68.6	67.2	69.0	67.2	65.3		Nov	62.2		

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