BDC
Entrepreneurs first

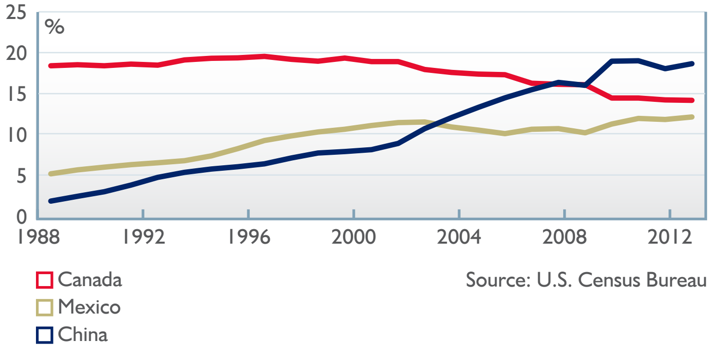
economic LETTER

NOVEMBER 2013

CHINA AND MEXICO EAT AWAY AT CANADA'S SHARE OF THE AMERICAN MARKET

Since the beginning of the new century, Canada's share of the American merchandise import market has gradually contracted, from 19% in 2001, to 14% in 2012. It is the emerging countries that have reaped the benefit, mainly China. As shown in Graph 1, China's market share has soared from 9.0% to 19% during this period, overtaking Canada as top supplier of goods to the United States in 2009.

Graph I: Canadian, Chinese and Mexican shares of American imports from 1988 to 2012



Canada's loss of competitiveness is mainly due to two factors: increasing global competition – resulting from the industrialization of many countries, especially China – and the appreciation of the Canadian dollar. Thanks to their abundant, cheap labour force, the emerging countries have been able to offer Americans a host of products comparable to those of Canada (and those of other developed countries) at much lower prices. The appreciation of the Canadian dollar against its U.S. counterpart during the first decade of this century has aggravated the situation.

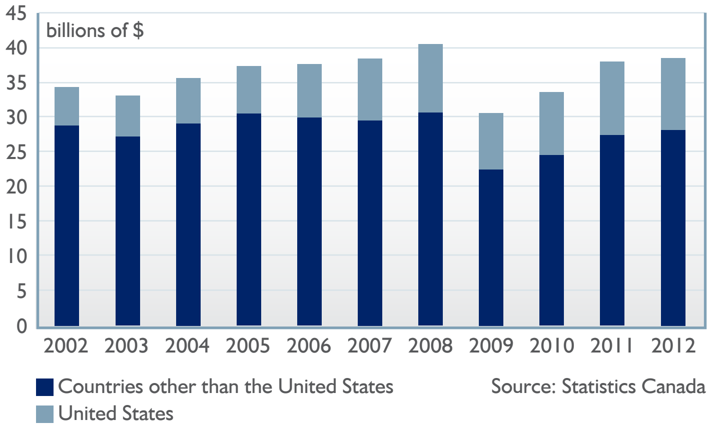
When China first started to become industrialized, the competition mainly made itself felt in sectors where Canada did not dominate the U.S. market, such as the garment and accessory industry. But Chinese competition quickly spread to the other sectors. Between 2002 and 2012, Canada's share of American ▼

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 November 9. Reliance on and use of this information is the reader's responsibility.

imports lost ground in 22 of the 24 major industry categories (see Table 1). China contributed to the decline of Canada's market share in all sectors except for four: primary metal manufacturing, beverages and tobacco, minerals and ores, and gas and petroleum (green boxes of the table). Most of these sectors are tied to natural resources, in which China's market shares are very small.

Meanwhile, the five industries in which Canada has suffered the greatest losses – i.e. paper, wood products, printed and related products, furniture and accessories and plastic and rubber products – are among those in which China has recorded the greatest gains. In some sectors where Canada held first place in American imports in 2002, China now dominates, and often by a large margin (blue boxes of the table). In the printed and related products sector, for example, Canada's market share has shrunk by half during this period (from 30% to 16%) while China's share has more than doubled (from 21% to 45%). In a few sectors, Canada has lost market share mainly to Mexico (mauve boxes of the table). This is the case in the primary metal manufacturing industry and in the transportation equipment sector, among others. The United States is importing increasing volumes of automotive parts from Mexico, to the detriment of the Canadian automobile industry.

Graph 2: Canada Exports to the United States and to all other countries



Source: Statistics Canada

Despite Canada's loss of competitiveness, the value of Canadian exports of goods to the United States kept rising, although sluggishly, between 2002 and 2008. This is due to the fact that American demand remained strong and to the fact that the prices of many exported goods, in particular energy products, rose considerably during that period. As for total exports, they recorded healthy growth thanks to increases in exports to other countries, the share of which rose from 16% in 2002, to 24% in 2008 (Graph 2). In 2009, the global recession caused by the financial crisis sent Canadian exports to the United States tumbling (-24%) along with those from other countries (-18%). They have rebounded since then, but in 2012, exports to the United States had still not returned to their pre-recession levels.

In light of this analysis, what should we expect for Canadian exports in the years ahead? This is an important question, since the majority of forecasters, including the Bank of Canada, are basing their expectations of accelerated economic growth in Canada in the coming years on a recovery of economic activity south of the border.

More vigorous economic activity in the United States should certainly result in higher American demand for Canadian products. That said, given that Canada's share of American imports is smaller than it used to be, the positive effect of a U.S. economic recovery on Canadian exports will also be smaller. Moreover, it is entirely possible that China and the other emerging countries will continue to expand their shares of the American market in the years to come, at Canada's expense. On the other hand, Canada might penetrate the emerging markets further. Currently, Canada's exposure to the strong-growth emerging countries is weak. This is what needs to be changed in the years ahead in order for Canadian exports to grow.

In the next economic letter, we will take a closer look at Canadian export trends, by destination and by sector, and attempt to identify which trends are the most promising for Canada.

1 We assume here that the prices of goods exported by Canada will be constant.

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Canada's, Mexico's and China's shares of U.S. imports, by industry	Canada			China			Mexico		
	2002	2012	Var.	2002	2012	Var.	2002	2012	Var.
Paper	65.2%	46.3%	-18.9	5.0%	15.4%	10.3	2.9%	4.9%	2.1
Wood products	62.8%	48.0%	-14.9	7.0%	24.4%	17.4	1.2%	1.2%	0.0
Printed matter and related products	30.3%	16.0%	-14.3	20.9%	45.1%	24.2	5.8%	9.0%	3.2
Furniture and fixtures	21.3%	8.5%	-12.8	38.9%	57.4%	18.4	6.3%	6.5%	0.2
Plastics and rubber products	29.6%	17.7%	-11.9	18.3%	31.5%	13.2	6.9%	8.8%	1.9
Primary metal manufactured	31.2%	21.6%	-9.6	2.4%	1.7%	-0.8	6.8%	13.8%	7.0
Fabricated metal products	17.0%	9.1%	-8.0	17.0%	30.3%	13.2	13.3%	11.4%	-1.8
Transportation equipment	29.1%	22.4%	-6.8	1.0%	3.9%	2.8	16.6%	22.7%	6.1
Food	31.8%	25.3%	-6.5	3.5%	7.1%	3.6	6.7%	10.6%	3.9
Textiles and fabrics	15.7%	10.0%	-5.8	6.3%	25.0%	18.6	6.7%	6.7%	0.0
Agriculture and livestock products	22.8%	17.2%	-5.7	4.1%	5.8%	1.8	13.5%	17.8%	4.3
Electrical equipment	9.4%	4.9%	-4.5	26.4%	37.3%	10.9	25.9%	25.0%	-0.9
Machinery except electrical	13.6%	9.4%	-4.2	8.1%	15.8%	7.7	6.6%	10.1%	3.5
Beverages and tobacco products	8.9%	4.8%	-4.1	4.7%	2.9%	-1.7	16.6%	15.9%	-0.6
Non metallic mineral products	12.8%	8.8%	-4.0	20.9%	33.5%	12.7	12.0%	12.6%	0.6
Textile mill products	6.3%	2.3%	-4.0	28.2%	51.8%	23.6	9.5%	4.4%	-5.1
Computer and electronic products	4.2%	2.1%	-2.1	16.1%	44.8%	28.7	15.0%	15.3%	0.4
Apparel and accessories	2.9%	0.8%	-2.1	14.8%	39.4%	24.6	12.4%	4.8%	-7.6
Mineral and ores	22.1%	20.3%	-1.9	3.7%	2.5%	-1.2	4.8%	4.3%	-0.5
Oil and gas	32.5%	31.4%	-1.2	0.1%	0.0%	-0.1	14.7%	14.4%	-0.3
Chemicals	12.8%	12.4%	-0.4	2.4%	7.5%	5.1	2.9%	2.5%	-0.4
Leather and allied products	0.6%	0.4%	-0.3	59.0%	67.5%	8.5	7.1%	5.9%	-1.2
Miscellaneous manufactured commodities	2.7%	2.8%	0.2	33.1%	35.8%	2.8	6.2%	7.0%	0.8
Petroleum and coal products	13.6%	14.7%	1.1	0.6%	0.1%	-0.4	2.7%	1.9%	-0.8

Source: U.S. Census Bureau

CANADA

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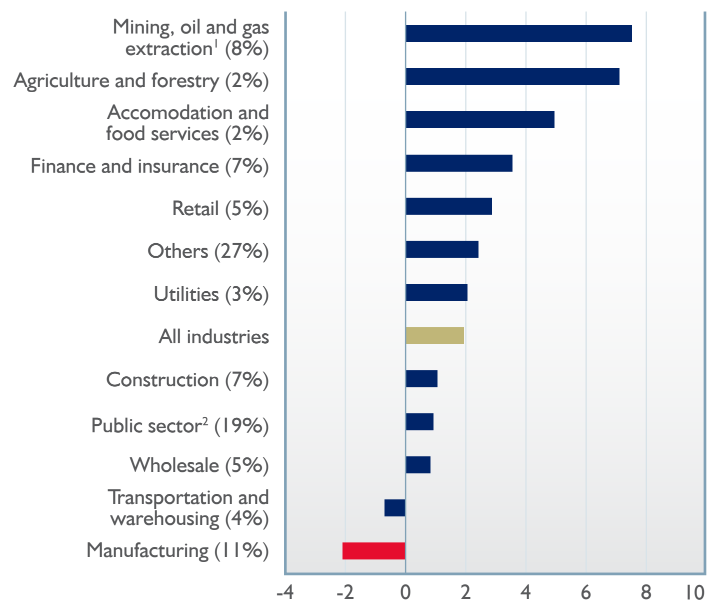
Results for the months of July and August suggest accelerated real GDP growth in Q3 from the previous quarter. The Macdonald-Laurier Institute leading indicator points to the firming up of economic activity through to the end of the year. This should lead, we hope, to an improvement in the labour market situation, which has been struggling since the beginning of the year.

Moderate real GDP growth

Real GDP by industry rose by 0.3% in August compared with the previous month. Production increased in the majority of sectors, particularly in mining and oil and gas extraction, whose contribution to real GDP growth soared to 50% in August. Production was unchanged in the construction sector, while utilities and the finance and insurance sector recorded slight declines. Lastly, manufacturing is the sector that saw the greatest setback in August. These are hard times in that sector, the only one besides transportation and

Real GDP by industry, change from August 2012 to August 2013



1. Includes quarrying
2. Education, health and public administration

Source: Statistics Canada

warehousing to record a production slump over the past 12 months (graph). The manufacturing sector's share of GDP has dropped sharply over time, from 15% at the beginning of the 2000s to 11% in 2013.

Employment growth remains weak

In October, full-time employment rose by 16,000, while part-time employment decreased by 2,700, for a net gain of only 13,200 jobs, a result similar to the previous month's (11,900 in September). The unemployment rate remained unchanged at 6.9%. Job creation in 2013 has been weak up to now. The average monthly variation in employment this year was only 12,630, while it reached almost 26,000, or more than double that, in 2012. The unemployment rate remained stable, oscillating around 7.0%, compared with about 6.0% before the recession.

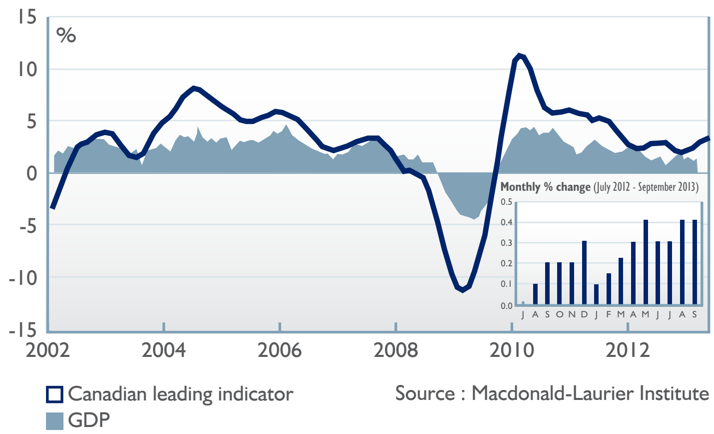
Housing starts and home sales edge up

Total housing starts increased by 1.2% in October from the previous month. They remained unchanged in urban centres, where an increase of 0.9% in multi-unit housing starts was offset by a drop of 1.7% in single-family homes. According to the Canada Mortgage and Housing Corporation, housing start trends, as measured by their average over the past six months, firmed up since summer, as forecast. Sales of existing homes rose by 0.8% in September compared with the previous month, and the number of new listings declined by 1.4% during that period. According to the Canadian Real Estate Association, the real estate market has tightened a little in recent months but it is still balanced, as it has been since the beginning of 2010.

Economic outlooks are improving

For the second straight month, the leading indicator compiled by the Macdonald-Laurier Institute recorded a monthly variation of 0.4% in September. All nine components of the indicator contributed to that increase, which had not happened since March 2011. Both indicators related to the manufacturing sector gained ground again, particularly durable goods orders which were up by 1.3%, their best result this year. According to the Institute, the leading indicator's current trend points towards continued strengthening of economic activity in Canada until 2014 at least.

Leading indicator, year-over-year change



Source : Macdonald-Laurier Institute

UNITED STATES

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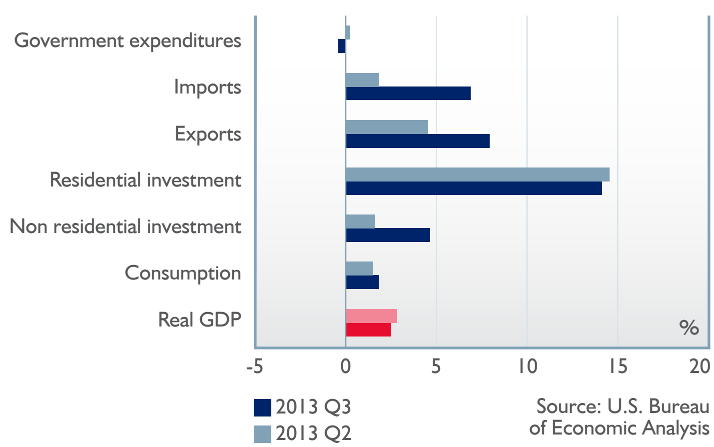
The most recent indicators point to an acceleration in economic activity: real GDP recorded stronger-than-expected growth in Q3, employment is growing slowly but surely, and the real estate market has regained momentum.

Real GDP maintains solid rate of growth

Real GDP increased 2.8% in Q3 from the previous quarter (annual rate), maintaining about the same rate of growth as the previous quarter (2.5%). All the main components of GDP contributed to its growth in Q3, except for government expenditures, which made hardly any contribution at all. Consumer spending, non-residential investment and exports grew at slower rates than the previous quarter (graph). Real GDP growth nevertheless accelerated slightly compared with Q2, due to the slowing down of imports and investment in inventory. Results for Q3 have proven to be better than forecasters' expectations, although the temporary federal government shutdown in early October may have had a negative impact on growth in Q4.

Real GDP and its main componants
(quarterly change at annual rate)



Source: U.S. Bureau of Economic Analysis

Employment continues to grow

Non-farm employment recorded a gain of 204,000 in October, and the data for August and September was revised upwards by 45,000 and 15,000, respectively. According to the Bureau of Labor Statistics, the temporary federal government shutdown in early October did not have any impact on results. The unemployment rate is practically unchanged, at 7.3% in October compared with 7.2% the previous month. The labour market situation is slowly but steadily improving. Just over 80% of the jobs lost since early 2008 have now been recovered.

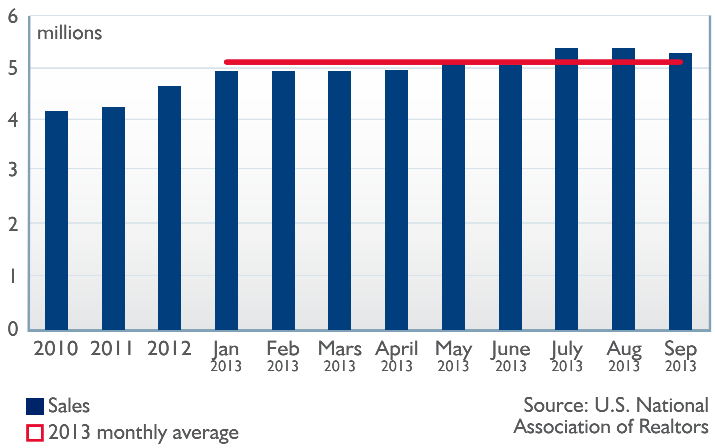
The real estate sector cools slightly

The September housing start data will be released later than scheduled due to the temporary shutdown of federal government services last October. As for existing home sales, after reaching a four-year high in recent months, they tumbled by 1.9% in September compared with the previous month. Still, they stand 10.7% higher than where they were in September 2012, and the shrinking inventory is continuing to push up the median price of homes. If this trend continues, home sales will record strong year-over-year growth in 2013 (graph). However, according to the National Association of Realtors, the recent increase in mortgage rates could slow real estate activity down in the coming months.

Consumers were perturbed by the federal government shutdown

The purchasing managers' index in the manufacturing sector, compiled by the Institute for Supply Management (ISM), inched up by 2 tenths of a percentage point, to 56.4. This means that manufacturing production and the economy in general are continuing to expand, and attests to the optimism of entrepreneurs. Generally speaking, they do not seem to have been overly distressed by the temporary federal government shutdown in October. But consumers seem to have been shaken by it. The Conference Board's consumer confidence index plunged by 9 percentage points in October, to 71.2. Similar downwards movements were observed at the end of 2012, when federal services were threatening to shut down if the Democrats and Republicans failed to reach an agreement on the budget and the debt ceiling, and in 1995 / 1996, when services were suspended for similar reasons. ■

Existing Home Sales (annual data from 2010 to 2012 and monthly data at annual rate from January to September 2013)



Source: U.S. National Association of Realtors

INTEREST RATES

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No change in sight for the key interest rate

On October 23, the Bank of Canada decided to leave its trendsetting interest rate unchanged. In the press release explaining its decision, the central bank omitted to mention, as it had been doing for several months, that a normalization of the key interest rate was to be expected in due course, once economic conditions returned to normal. The withdrawal of this warning clearly signifies that the key interest rate will stay where it is for a long time to come. The outlooks for Canadian economic growth, published the same day in the Monetary Policy Report, were revised downwards from what they were in July. The Bank is expecting weaker global economic growth – particularly in the United States – which will result in a smaller contribution to economic growth from Canadian exports and business investment (see table). ■

Contributions to annual real GDP growth, percentage points*

	2012	2013	2014	2015
Consumption	1.1(1.1)	1.3 (1.0)	1.3 (1.4)	1.4 (1.5)
Housing	0.4 (0.4)	-0.1 (-0.1)	0.0 (-0.1)	0.0 (0.0)
Public administration	0.3 (0.3)	0.3 (0.3)	0.1 (0.0)	0.1 (0.1)
Business fixed investment	0.6 (0.6)	0.1 (0.2)	0.4 (0.6)	0.8 (0.9)
Exports	0.4 (0.4)	0.3 (0.8)	1.0 (1.4)	1.5 (1.3)
Imports	-1.0 (-1.0)	-0.4 (-0.2)	-0.7 (-0.8)	-1.2 (-1.1)
Real GDP	**1.7 (1.7)**	**1.6 (1.8)**	**2.3 (2.7)**	**2.6 (2.7)**

* Figures in parentheses are from the projection in the July 2013 Monetary Policy Report.

Source: Monetary Policy Report, Bank of Canada, October 2013.

OIL AND THE LOONIE

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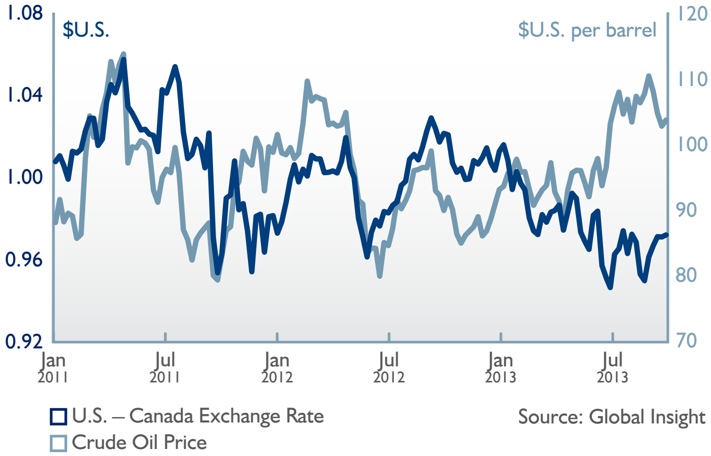
The price of oil declines and the Canadian dollar depreciates

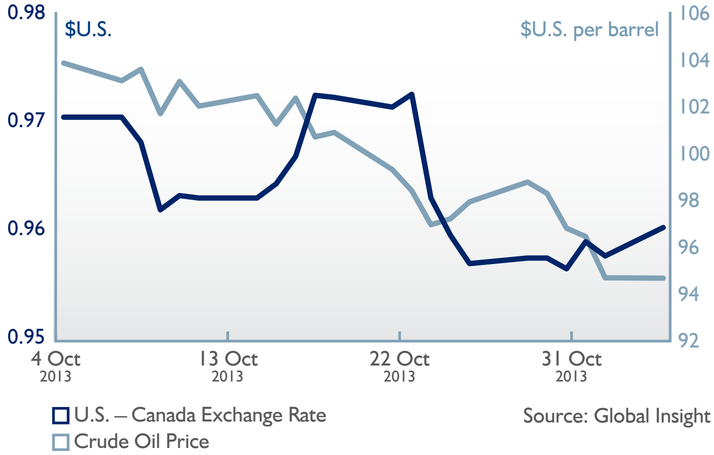
The price of a barrel of crude oil (West Texas Intermediate) has gradually declined in recent weeks, due to an expanding supply in the United States. Thanks to shale oil operations, some experts believe that the price of oil might well fall below US$90 per barrel within a few months. In September, China overtook the United States as the world's top importer of crude oil. As for the Canadian dollar, it depreciated slightly against the U.S. dollar during the month, slipping from US$0.97 to US$0.96.

Exchange Rate and Crude Oil Price
(January 2011 to November 2013)



Source: Global Insight

Exchange Rate and Crude Oil Price
(October 4, 2013 to November 4, 2013)



Source: Global Insight

SME CONFIDENCE

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SME owners' optimism remains steady

The Business Barometer Index compiled by the Canadian Federation of Independent Business gained half a point in October, reaching 65.0. After a temporary dip in the spring, the index rebounded during the summer and has remained relatively stable since then. Despite a slight pullback since the start of the year, it is the business services sector that is showing the greatest optimism (see table). Enterprises in the manufacturing sector are in second place, with an index slightly higher than where it stood at the start of the year. This offers some hope that manufacturing production may pick up in the months ahead. Optimism in the natural resources sector has greatly improved during the year, as may be seen from the 15.9 point increase in the index since January. Conversely, enterprises in the transportation and agriculture sectors are less positive than they were in January and are pulling up the rear.

Business Barometer, by industry	Level in October 2013	Change from January 2013
Professional and business services	70.2	-3.5
Manufacturing	70.0	3.8
Natural resources	70.0	15.9
Health and educational services	68.8	6.1
Information, arts and recreation	68.8	0.2
Construction	66.5	2.1
Wholesale	66.4	3.4
Hospitality	65.7	8.6
Other services	64.9	1.7
Retail	61.9	-3.2
Finance, insurance and realty	60.0	-9.6
Transportation	56.8	-1.5
Agriculture	56.5	-4.4
Global index	**65.0**	**-0.7**

Source: Canadian Federation of Independent Business

BUSINESS CREDIT CONDITIONS

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Growth in short-term bank credit slows

The growth in short-term credit granted to businesses by the chartered banks slowed in September, with a monthly variation of just 1.8%. Meanwhile, long-term credit grew sharply, surging by 8.1% in September compared with August. 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 – has declined slightly. It had grown in previous months, when the financial markets were anticipating, after a statement by Chairman Bernanke, that the Federal Reserve would taper its Treasury asset purchases by the end of this year (graph).

Effective Business Interest Rate

Source: Bank of Canada

KEY INDICATORS – CANADA

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Key indicators – Canada

	Historical[1]				2013[2]				2013[3]		Forecast	
	2009	2010	2011	2012	Q1	Q2	Q3	Q4	Latest		2013	2014
Real GDP (% growth)	-2.7	3.4	2.5	1.7	2.2	1.7			Aug	0.3	1.7	2.3
Machinery and Equipment Expenditures (% growth)	-21.2	10.6	8.6	5.2	-0.1	-2.1					1.0	4.7
Pre-Tax Corporate Profits (% growth)	-45.4	61.6	16.6	-8.2	9.6	-32.6					-4.8	4.4
Industrial Production (% growth)	-11.0	6.0	3.9	0.9	5.3	-2.0			Aug	0.5	0.5	2.1
Industrial Product Prices (% growth)	-3.5	1.0	4.6	0.6	4.5	-1.1			Sep	-0.3	1.0	1.7
Non-Residential Construction (% growth)	-19.4	17.3	12.9	6.9	1.5	-2.8						
Housing Starts (' 000 units)	148	191	193	215	175	190	193		Oct	198	184	174
Personal Expenditures (% growth)	0.3	3.5	2.3	1.9	1.3	3.8					2.1	2.1
Consumer Price (% growth)	0.3	1.8	2.9	1.5	1.6	3.8			Sep	0.2	1.1	1.8
Employment (% growth)	-1.6	1.4	1.5	1.2	0.8	1.3	0.8		Oct	0.1		
Unemployment Rate (%)	8.3	8.0	7.5	7.3	7.1	7.1	7.1		Oct	6.9	7.1	6.9
SMEs Confidence Index (CFIB)	57.7	66.7	66.4	63.9	64.9	61.3	64.8		Oct	65.0		
Manufacturers Confidence Index (CFIB)	56.0	68.5	67.3	66.7	65.6	58.3	65.4		Oct	70.0		

1. Annual growth rate
2. Quarterly growth, at annual rate
3. Month-over-month growth

Sources: Statistics Canada, Consensus Economics and Canadian Federation of Independent Business.