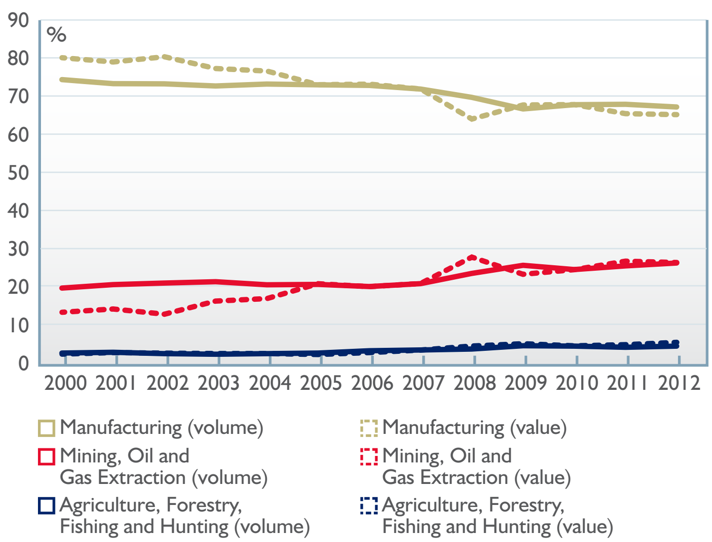
BDC
Entrepreneurs first

economic LETTER
DECEMBER 2013

CANADA SLOWLY PENETRATES THE EMERGING MARKETS

Many changes have taken place in Canadian exports since the beginning of the 2000s, in terms of both the types of products exported and their destinations. Between 2000 and 2012, total exports expanded by 1% per year, on average (see Table 1). The proportion of those heading to the United States dropped significantly during that period, from 87% in 2000 to 75% in 2012. This was mainly to the benefit of the emerging countries, whose share of exports nearly tripled, from 4% in 2000 to 11% in 2012. Canadian exports to China, for example, shot up by 15% per year, on average, during this period. The percentage of exports headed for western European countries also increased. This is mainly attributable to the surge in exports to the United Kingdom which soared by an average of 10% per year between 2000 and 2012. As shown in Table 1, exports to that country in the mining and oil and gas extraction sector escalated by an average of 31% per year during this period. ▼

Chart I: Distribution of Canadien exports of goods between the three main industries, from 2000 to 2012



Source: Statistics Canada

Canada

- Real GDP growth accelerates
- Employment rises moderately
- The balance of trade returns to a surplus position
- Timid growth in consumer prices

United States

- Real GDP growth is revised upwards
- The job market continues to improve
- Business confidence firms up

Interest rates

No key interest rate hike in sight before 2015

Oil and dollar

SME confidence

Credit conditions

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

The distribution of Canadian exports by industry has also changed a good deal since 2000. The proportion of exports from the agriculture, forestry, hunting and fishing sector rose from 3% in 2000 to 6% in 2012, while that of the mining and oil and gas extraction industry climbed from 14% to 27%. Conversely, the manufacturing industry's share tumbled from 80% to 65%. Naturally, price effects are at play here, since these percentages are calculated based on the value of the exports. The rising price of oil over the past decade partly accounts for the expanded share of the mining and oil and gas extraction sector. That said, even in terms of volume, that sector's share has grown at the expense of that of manufacturing, as may be seen in Graph 1.

The United States claims a much smaller share of exports in the agriculture, forestry, hunting and fishing sector compared with the two other industries. This was already the case in 2000, when slightly less than half of the exports in this sector were headed for the United States, one third to the emerging countries, 10% to Japan and 7% to western Europe. In 2012, the shares of the United States and the emerging countries were reversed compared with 2000: 31% of the exports in this sector went to the United States, and 45% to the emerging countries. China was largely behind that result: Canadian exports of agricultural, livestock and forest products to that country expanded respectively by 16%, 33% and 61% per year, on average, during this period.

Table I: Share of the total value of Canadian exports by destination and by industry in 2000 and in 2012, and average annual growth rate (AAGR) between 2000 and 2012

	2000	2012	AAGR
Total Exports			**1.0%**
United States	86.9%	74.6%	-0.5%
Emerging countries[1]	3.9%	11.3%	10.2%
Of which China	0.9%	4.3%	14.8%
Western European countries	4.9%	8.8%	5.9%
Of which United Kingdom	1.4%	4.1%	10.4%
All other countries	4.2%	5.4%	2.7%
Agriculture, Forestry, Fishing and Hunting	**2.8%**	**5.9%**	**5.7%**
United States	45.5%	31.1%	2.4%
Emerging countries[1]	33.4%	44.7%	8.3%
Of which China	4.4%	14.8%	17.0%
Western European countries	7.5%	8.5%	6.9%
Of which United Kingdom	1.5%	1.0%	2.0%
Japan	10.2%	11.4%	6.7%
All other countries	3.4%	4.2%	7.7%
Mining and Oil and Gas Extraction	**13.7%**	**26.7%**	**7.6%**
United States	87.3%	73.8%	6.1%
Emerging countries[1]	3.6%	7.8%	14.8%
Of which China	1.3%	4.3%	18.8%
Western European countries	4.8%	13.6%	17.5%
Of which United Kingdom	1.1%	10.7%	30.6%
All other countries	4.3%	4.8%	8.4%
Manufacturing	**80.2%**	**65.2%**	**-0.8%**
United States	87.6%	77.8%	-1.8%
Emerging countries[1]	3.1%	10.4%	9.6%
Of which China	0.8%	3.4%	12.3%
Western European countries	5.3%	7.4%	2.0%
Of which United Kingdom	1.5%	1.8%	0.6%
All other countries	4.0%	4.4%	-0.8%
Other industries[2]	**3.3%**	**2.1%**	**-3.0%**

1. Emerging market economies as defined by the International Monetary Funds
2. Exports of electricity and special transactions

Back

Growing demand from the emerging countries for energy and mineral products, combined with higher prices, helped push up exports in the mining and oil and gas extraction industry by an average of 8% per year between 2000 and 2012. However, as mentioned earlier, it was mainly the United Kingdom's share that expanded during this period. That country has become a new destination for exports of oil from Newfoundland, and sales of metallic minerals (which account for 90% of this sector's exports to the U.K.) have gone up significantly since 2000.

While exports of agricultural, forest, oil and mining products have increased since 2000, those of manufactured goods have decreased by an average of 1% per year. Higher sales to other countries have failed to fully compensate for the decline in manufacturing exports to the United States. Nevertheless, the share of emerging markets has actually tripled, from 3% to 10%, while that of western European countries has expanded by 50%. Despite this, the United States is still by far the main foreign customer of Canada's manufacturing industry, claiming 78% of its exports.

Many Canadian manufacturing industries are managing to break into the emerging markets. Table 2 shows the growth in the value of exports of manufactured goods to China, by sub-sector. It comes as no surprise that the oil and coal products sector has recorded the strongest growth in exports to China, since demand for these products in the emerging countries is very strong and their prices have risen substantially. Wood products hold third place: China is importing more and more of them from British Columbia. The food sector is also exporting more to China, in particular canned fruits and vegetables, specialty food products, sugar, confectionaries and meat, no doubt due to the improved standard of living of the Chinese middle class which is stimulating demand for these products. Machinery, paper and computer products, which together represent 16% of manufacturing exports, have also recorded average annual increases of over 10% in their exports to China between 2000 and 2012. Exports of transportation equipment have declined during this period, but certain sub-sectors are doing very well, such as aerospace products and parts, exports of which to many emerging countries (India, United Arab Emirates, Indonesia and Mexico) have been very strong during this period.

In short, Canada is gradually penetrating the emerging markets. This is happening slowly, but surely. It has taken 10 years to triple the proportion of Canadian exports to the emerging countries, and it still stands at just 11%. Canadian companies will have to keep working hard in order for this trend to continue.

Table 2: Average annual growth in the value of exports of Canadian manufactured products to China between 2000 and 2012

	Sector's share in total exports of manufactured products*	AAGR of manufactured exports to China, from 2000 to 2012
Petroleum and Coal Products	8.1%	50.4%
Beverages and Tobacco Products	0.4%	43.8%
Wood Products	3.1%	40.9%
Primary Metals	9.7%	31.8%
Clothing	0.4%	23.0%
Food	7.2%	20.8%
Non-Metallic Mineral Products	0.6%	20.4%
Textile Mills	0.3%	17.6%
Textile Product Mills	0.2%	16.3%
Furniture and Related Products	1.3%	15.9%
Machinery	7.2%	14.1%
Paper	4.6%	12.4%
Computer and Electronic Products	4.2%	11.5%
Printing and Related Support Activities	0.3%	11.4%
Electrical Equipment, Appliances and Components	1.9%	11.3%
Chemicals	9.4%	7.2%
Miscellaneous Manufacturing	1.5%	3.7%
Fabricated Metal Products	2.3%	1.3%
Transportation Equipment	24.9%	-0.6%
Leather and Allied Products	0.1%	-2.5%
Plastics and Rubber Products	2.5%	-11.3%

* The total does not equal 100 because 10% of exports of manufactured goods classified in «other» category are not broken down by country.

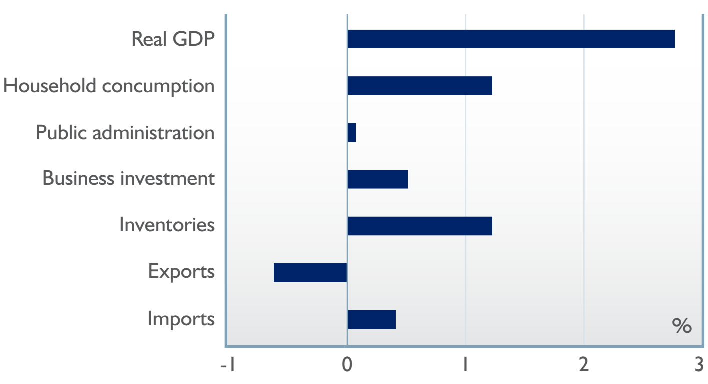
Back

The latest indicators show that economic growth is proceeding at a moderate pace in Canada. Real GDP growth should have no problem reaching the consensus forecast of 1.7% for 2013, since all that is needed is growth of 1.2% in the fourth quarter; but it would be surprising for it to exceed that forecast by much.

Real GDP growth accelerates

Real GDP grew by 2.7% in the third quarter of 2013, after growth of 1.6% in the previous quarter. Nearly half of the growth recorded in the third quarter (44% to be exact) comes from business inventory investment (Graph). Growth in consumer spending slowed from the second to the third quarter, from 3.6% to 2.2%. After a pullback of 1.3% in the second quarter, non-residential investment advanced by 2.2% in the third. Residential investment also expanded in the third quarter, but at a slower pace than in the previous quarter (2.4% versus 6.8%). Exports and imports of goods and services declined by 2.0% and 1.4% respectively. This third-quarter real GDP growth was a little stronger than most forecasters were anticipating, but it is largely due to stockpiling, an effect that could well be reversed in the next quarter.

Contribution to quarterly change (at annual rate) in real GDP, third quarter 2013



Source: Statistics Canada

Employment rises moderately

After a modest gain of 13,200 jobs in October, employment expanded by just under 22,000 jobs in November, consisting of 1,400 full-time jobs and 20,000 part-time jobs. The unemployment rate held steady at 6.9% for the third straight month. Employment growth since the beginning of the year, based on the monthly average from January to November, stands at 1.3%, compared with 1.1% for the same period of 2012.

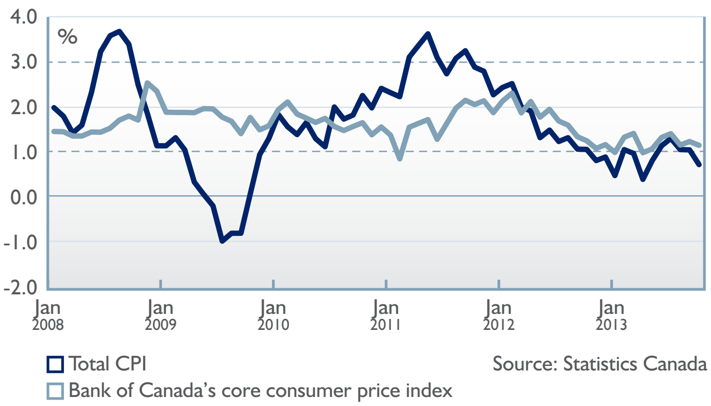
The balance of trade returns to a surplus position

A greater monthly pullback in imports than in exports (-1.2% versus -0.3%) resulted in an improved balance of trade: it moved from a $303 million deficit in September to a $75 million surplus in October. For both imports and exports, the pullbacks are attributable to lower prices. Canada's trade surplus with the United States shrank somewhat, from $4.1 billion in September to $3.9 billion in October, while the deficit with countries other than the United States contracted, from $4.4 billion to $3.9 billion.

Timid growth in consumer prices

The Consumer Price Index was down by 0.1% in October compared with the previous month. The inflation rate, measured by the annual growth in the Consumer Price Index, came in at 0.7% in October, compared with 1.1% in the previous month. In recent months, the inflation rate has fallen below the Bank of Canada's bottom threshold of 1.0% on several occasions. According to the central bank's core index, which excludes the most volatile consumer prices, inflation stood at 1.2% in October. This measurement of inflation has remained within the central bank's target range, but has been very close to the bottom end for several months now. In short, both indexes show that growth in consumer prices is weak, suggesting that the economy is currently not running at full capacity. ■

Inflation measured by the annual change in the consumption price index (January 2008 to October 2013)



Source: Statistics Canada

UNITED STATES

Back

The strong real GDP growth in the third quarter, which is largely due to business inventory investment, clearly overestimates the strength of economic activity in the United States. That said, the definite improvement in the labour market and the resurgence of business confidence give reason to believe that the economic recovery is gaining traction.

Real GDP growth is revised upwards

According to the second estimate compiled by the U.S. Bureau of Economic Analysis, real GDP grew by 3.6% in the third quarter of 2013, instead of the 2.8% shown by the preliminary data. The difference is apparently mainly due to a greater increase in private business inventory investment. The contribution to economic growth by that investment is 1.68 percentage points, nearly half of real GDP growth. It is quite likely that this effect will be reversed in the next quarter.

The job market continues to improve

In November, non-farm employment expanded by 203,000 jobs, similar to the previous month (200,000). The unemployment rate fell to 7.0%, its lowest point in five years, whereas it stood at 6.8% in November 2008 (Graph). Apart from government services, all the industries recorded gains in November. Since the beginning of 2013, employment has grown by 189,000 jobs per month, on average, compared with a monthly average of 179,000 during the same period of 2012.

Unemployment Rate (January 2007 to November 2013)

Source: U.S. Bureau of Labor Statistics

Business confidence firms up

The Purchasing Managers' Index compiled by the Institute for Supply Management, a good indicator of business leaders' confidence in the manufacturing sector, continued to advance in November with a gain of 0.9 percentage points, reaching 57.3%. This is its highest score since March 2011 (Graph). The new orders, production and employment indexes all showed healthy growth in November, and the comments made by the survey respondents were generally very positive. ■

Purchasing Manager Index – Manufacturing Sector
(January 2007 to November 2013)

Source: Institute for Supply Management

INTEREST RATES

Back

No key interest rate hike in sight before 2015

On December 4, the Bank of Canada announced that it was leaving the key interest rate unchanged, at 1.0%, but, as in October, it expressed concern that inflation was weaker than expected. In these circumstances, some analysts believe that the central bank might lower the key interest rate further in an effort to stimulate demand and put upward pressure on prices. However, many analysts doubt that lower interest rates would have much effect on demand, given that rates have been very low for over three years now, or believe that the Bank would be reluctant to encourage consumers to take on more debt. For the time being, the majority of forecasters expect the key interest rate to stay where it is, but most of them have deferred their expectations of a hike to early 2015 instead of late 2014. ■

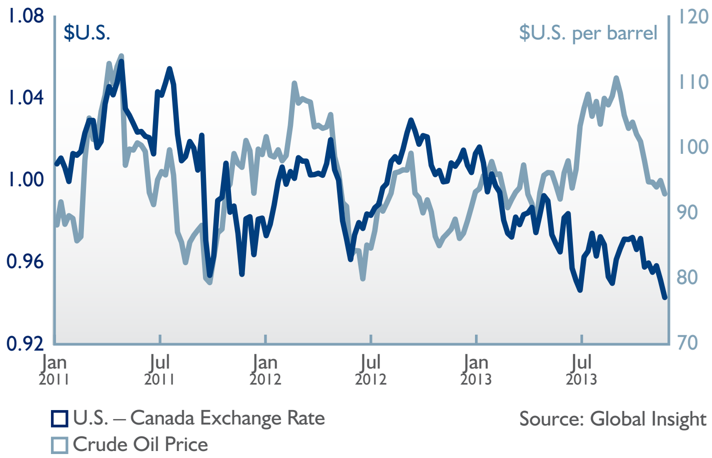
OIL AND THE LOONIE

Back

The price of oil remains stable, the Canadian dollar depreciates

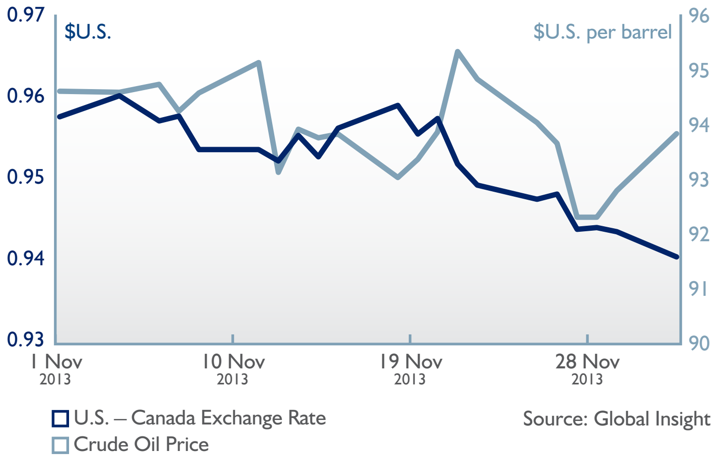
After declining in recent months due to expanded supply in the global market, the price of crude oil stayed relatively stable in November, oscillating around US$94 per barrel. After a temporary agreement on Tehran's nuclear program was reached between Iran and the group consisting of China, the United States, France, the United Kingdom, Russia and Germany, several of the sanctions against Iran were lifted, but not those on oil exports. If a conclusive agreement were reached and that sanction also disappeared, Iran would be ready to return immediately to full production capacity. According to the experts, this would put some downward pressure on the price of crude oil, the supply of which is already abundant. Meanwhile, the Canadian dollar depreciated against the U.S. dollar during November, from US$0.96 at the beginning of that month to US$0.94 at the beginning of December. Given the weakness of inflation, some forecasters were surmising that the Bank of Canada might lower its key interest rate, and this put downwards pressure on the loonie. ■

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



Source: Global Insight

Exchange Rate and Crude Oil Price
(November 1, 2013 to December 2, 2013)



Source: Global Insight

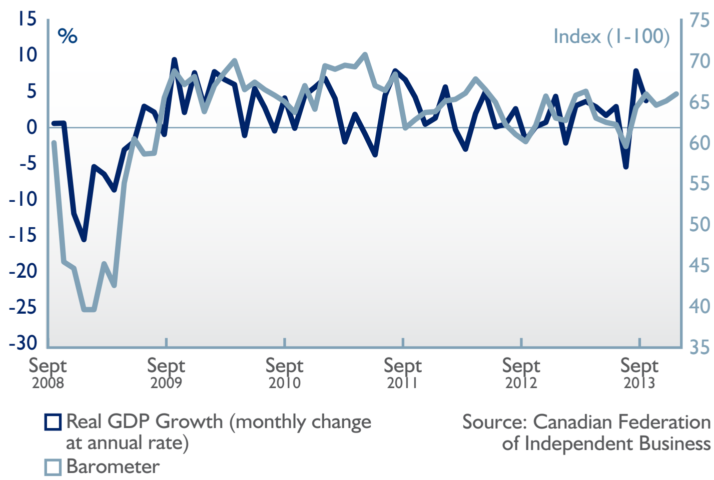
SME CONFIDENCE

Back

Greater optimism among SME owners

The Canadian Federation of Independent Business's Business Barometer Index gained 0.8 points, reaching 65.9 in November and returning to where it stood in August (Graph). Despite a decline in the province's index in November, business leaders in Newfoundland and Labrador are still the most optimistic in the country. Apart from that province, it is clear that SME owners in the eastern and central parts of the country are far less optimistic than those in the western provinces. Looking at the breakdown by economic sector, the variations are not terribly pronounced: the agricultural sector comes in at the bottom, with a reading of 57.3, while that of healthcare and education services comes in at the top, with 70.1. The other indicators of the survey (hiring intentions, price and salary increases, etc.) did not vary much from the previous month. ■

Business Barometer
(September 2008 to November 2013)



Source: Canadian Federation of Independent Business

BUSINESS CREDIT CONDITIONS

Back

Growth in short-term bank credit slows further

After monthly growth of 1.8% in September, short-term credit granted to businesses by the chartered banks ticked up by a slim 0.7% in October. Growth in long-term credit, which accounts for 13% of total bank credit, also slowed but, with a reading of 4.6% in October, it is still relatively strong. Annual growth in total bank credit has dropped from a peak of 15% in March 2013, to 10% in October 2013 (Graph).

Business Credit from Chartered Banks
(annual change, January 2007 to October 2013)

Source: Bank of Canada

KEY INDICATORS – CANADA

Back

Key indicators – Canada	Historical[1] 2009	2010	2011	2012	2013[2] Q1	Q2	Q3	Q4	2013[3] Latest		Forecast 2013	2014
Real GDP (% growth)	-2.7	3.4	2.5	1.7	2.3	1.6	2.7		Sep	0.3	1.7	2.2
Machinery and Equipment Expenditures (% growth)	-21.2	10.6	8.6	5.2	0.7	-0.2	2.5				1.0	4.6
Pre-Tax Corporate Profits (% growth)	-45.4	61.6	16.6	-8.2	9.4	-39.9	66.7				-5.0	4.0
Industrial Production (% growth)	-11.0	6.0	3.9	0.9	5.9	-2.5	4.5		Sep	0.7	0.9	2.0
Industrial Product Prices (% growth)	-3.5	1.0	4.6	0.6	4.5	-1.0	1.6		Oct	0.3	0.9	1.6
Non-Residential Construction (% growth)	-19.4	17.3	12.9	6.9	1.9	-1.9	2.1					
Housing Starts (' 000 units)	148	191	193	215	175	190	193		Nov	176	186	175
Personal Expenditures (% growth)	0.3	3.5	2.3	1.9	1.1	3.6	2.2				2.1	2.1
Consumer Price (% growth)	0.3	1.8	2.9	1.5	1.6	0.0	1.5		Oct	0.0	1.1	1.7
Employment (% growth)	-1.6	1.4	1.5	1.2	0.8	1.3	0.8		Nov	0.1		
Unemployment Rate (%)	8.3	8.0	7.5	7.3	7.1	7.1	7.1		Nov	6.9	7.1	6.9
SMEs Confidence Index (CFIB)	57.7	66.7	66.4	63.9	64.9	61.3	64.8		Nov	65.9		
Manufacturers Confidence Index (CFIB)	56.0	68.5	67.3	66.7	65.6	58.3	65.4		Nov	66.4		

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.