Entrepreneurs first

economic LETTER

MAY 2014

THE CANADA-EU TRADE AGREEMENT: WHICH SECTORS WILL BENEFIT?

Canada recently signed a free trade agreement with the European Union. The Canada-European Union Comprehensive Economic and Trade Agreement (CETA) is more than just a basic free trade agreement, however. Besides facilitating trade through the elimination of customs duties and expansion of quotas, the agreement also covers many other economic issues, such as direct investment, labour mobility and the mutual recognition of regulatory standards.

The European Union (EU) consists of 28 countries. Its population is 503 million, and its GDP, $19,677 billion, exceeds that of the United States. The EU's trade with the rest of the world represents approximately 20% of the total volume of global imports and exports.[1]

The EU is Canada's largest trading partner after the United States. In 2013, the value of Canadian merchandise exports to the region amounted to $33 billion, i.e. 7% of total exports, while Canadian imports from the EU stood at $53.2 billion, or 11.2% of the total value of imports. Since Canada imports more from the EU than it exports there, its trade balance with the region is in deficit (graph, page 2).

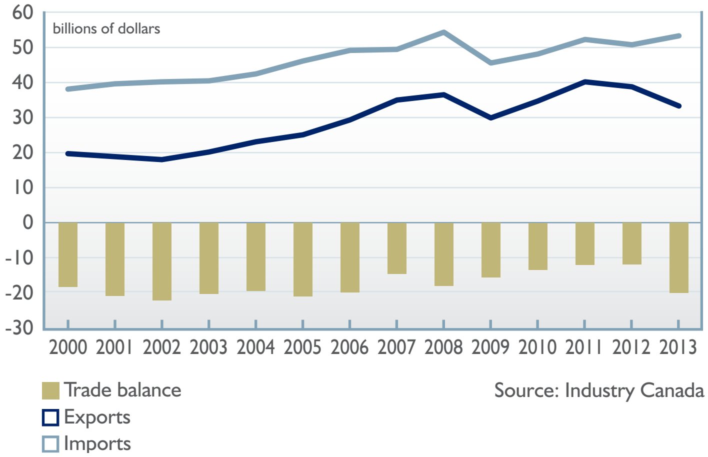
The elimination of customs duties and the reduction of other obstacles to trade (such as duplicative licensing and regulatory requirements, and other administrative constraints) will give Canadian exporters an edge over their international competitors, which are still subject to these constraints. The fact that Canada has reached an agreement with this part of the world while the United States (among others) has yet to do so, gives Canadian companies a head start over their American competitors. This is an undeniable advantage.

The CETA will promote the trade of many Canadian manufactured goods that are currently subject to substantial trade duties. Among those most likely to benefit are aerospace products, machinery, and computer, electronic and electrical hardware, which account for 36% of Canada's exports of manufactured products to the EU. On certain products, customs duties on these goods are as much ▼

1 Data from 2012. Source: http://europa.eu/about-eu/facts-figures/economy/index_en.htm

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 May 10. Reliance on and use of this information is the reader's responsibility.

Trade between Canada and the European Union
(2000 to 2013)



as 22%. Automotive vehicles and parts, for which tariff rates are 11.2% on average, will also benefit, but for Canadian automakers, the greatest gain is the quantity of vehicles that will be exempt from EU tariffs: 100,000 per year, or 12 times the number of vehicles that are currently exported to the EU.

The agricultural sector will also stand to gain from the agreement, especially the beef and pork industry. The quantities of beef and pork that Canada will be able to export to the EU free of customs duties will increase significantly, and the 20% customs tariff that currently applies to high quality beef will be eliminated. Many other agricultural producers will also benefit from the CETA thanks to the elimination of tariffs on their products; these include producers of wheat and grains, fruits and vegetables, oil and maple syrup.

The commodities sector (especially metals and minerals) and the industrial products sector will not gain as much, because most of these goods are already exempt from customs duties when they enter the EU.

The majority of tariffs will disappear as soon as the agreement comes into force, but some of them, in particular those that apply to automotive vehicles and wheat, will be phased out gradually over a period of three, five or seven years, depending on the product.[2]

The CETA also contains measures, such as access to government contracts and the adoption of new rules to encourage foreign direct investment, which will benefit firms in Canada's services sector. Access to government contracts means that Canadian firms will be able to supply goods and services to European institutions, to the governments of the 28 EU member countries and to its thousands of regional and municipal governments – a market estimated to be worth $2.7 trillion per year. Since nearly 20% of the EU's contracts pertain to the procurement of business services, this means that Canadian workers in the fields of architecture, construction, environmental services, technology, marketing consulting and research and development, among others, will gain greater access to EU government contracts. In terms of direct investment, rules that guarantee Canadian investors more secure access to the EU should be of interest to the energy, mining and manufacturing sectors as well as financial services, automotive vehicles, aerospace, transportation, business services and professional services.

In conclusion, many sectors of the Canadian economy stand to benefit from this agreement. Canadian businesses need to diversify their export markets. By expanding their access to the market of one of Canada's leading international trading partners, the CETA will give them an excellent opportunity to do just that. ■

CANADA

Back

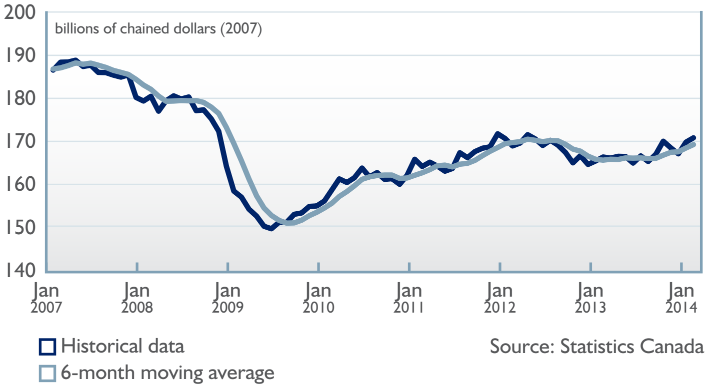
Economic growth was modest in the first quarter, as expected. Merchandise exports were down, but this was partly due to the slowdown of activity in the United States, caused by bad weather. Things should get back to normal in the second quarter, but the weak job creation in recent months suggests that demand is still limp.

Real GDP increases modestly

After rebounding in January, real GDP growth came in at 0.2% in February. Half of that growth is attributable to the mining and oil and gas extraction sector, whose production rose by 1.5% during the month. Meanwhile, manufacturing production gained 0.6% in February after a monthly increase of 1.6% in January. This sector seems to be gaining some traction, since its production has been back on an upwards trend for a few months now (graph). If real GDP continues growing at the same pace in March (i.e. 0.2%), annualized growth for the first quarter of 2014 will reach 2.0%. ▼

2 It is unknown at this time exactly when the CETA will come into force. The agreement must first be ratified by the governments of both parties (the provinces of Canada and the member countries of the EU) and then be subjected to a judicial review, and the final text must be translated into several languages. According to observers, this process should be completed in 2015.

Manufacturing GDP
(January 2007 to February 2014)



Source: Statistics Canada

Employment declines

Employment declined by 28,900 jobs in April, but the unemployment rate held steady at 6.9% due to a slight contraction in the labour force. The downturn in employment is entirely attributable to full-time employment, which lost 30,900 jobs, while 2,000 part-time jobs were created. In the past 12 months, the job market has recorded a net gain of 149,200 jobs distributed fairly evenly between full-time and part-time positions. But the majority of these gains were made during the first few months of that period, because since August 2013, job growth has been slack. At first glance, Canada's unemployment rate is higher than that of the United States, which stood at 6.3% in April (see the analysis of the U.S. job market on page 5). But the two countries' unemployment rates are not comparable, because they are designed differently. If the Canadian unemployment rate were calculated according to the American concept, Statistics Canada says it would stand at 6.0%.

The trade surplus narrows

The value of exports fell by 1.4% in March, while that of imports rose by 0.4%, melting the trade surplus from $847 million in February to $79 million in March. The decline in exports is mainly attributable to energy products, whose value tumbled significantly, although exports of forest products and building materials also recorded pullbacks. In the latter case, the cause could be the construction slowdown in the United States, as many states were hit by violent snowstorms this past winter. The March data bring the quarter to a close, and we can already anticipate that merchandise exports will have made a negative contribution to first-quarter economic growth. If the severe weather that battered the United States is indeed the reason, or at least one reason, for the slackness in Canadian exports, there should be rebound in the second quarter.

Housing starts rally

In April, housing starts more than recovered the ground lost in March, advancing by 24.4% after an 18.3% pullback in the previous month. Since October 2013, housing starts have been following a downwards trend (graph). The average over the first four months of the year is 179,870 units (at an annual rate); this is less than the 187,300 units that the Canada Mortgage and Housing Corporation (CMHC) had forecast for the year 2014 as a whole. Nevertheless, the CMHC considers that the housing start trend is in line with its expectations of a soft landing for homebuilding in Canada in 2014. ■

Housing starts
(January 2008 to April 2014)

Source : Canada Mortgage and Housing Corporation

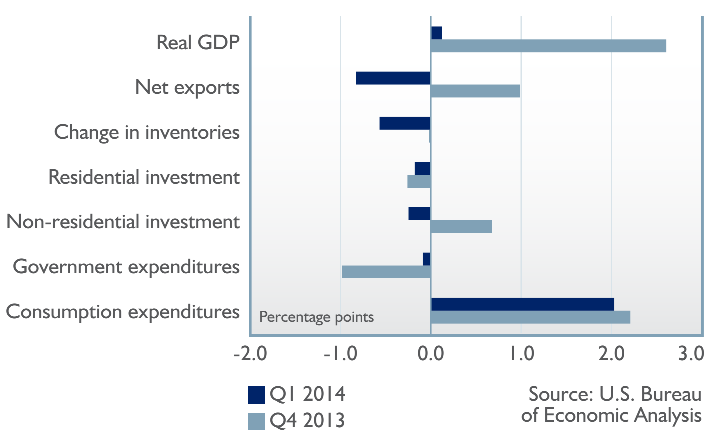
Back

Real GDP did not grow during the first quarter of 2014. This is partly due to the fact that economic activity was disrupted by harsh winter weather. Growth should rebound in the second quarter, since these seasonal effects are merely temporary. The strong job growth in recent months suggests that economic growth has indeed accelerated.

Real GDP stays flat

Real GDP remained static in the first quarter of 2014 compared with the previous quarter, according to the preliminary estimates of the U.S. Bureau of Economic Analysis. Keep in mind that in the last quarter of 2013, it grew at an annual rate of 2.7%. Of the main components of GDP, only consumer spending (which rose by 3.0%) made a positive contribution to growth in the first quarter of this year (graph). Non-residential investment dropped by 2.1%, residential investment by 5.7% and government spending by 0.5%. Exports fell much more than imports (7.6% versus -1.4%), so net exports made a negative contribution to growth. The severe weather conditions of a very harsh winter slowed economic production in the first quarter of the year. Growth should rebound in the next quarter, once these effects have dissipated.

Contribution to percent change in real GDP

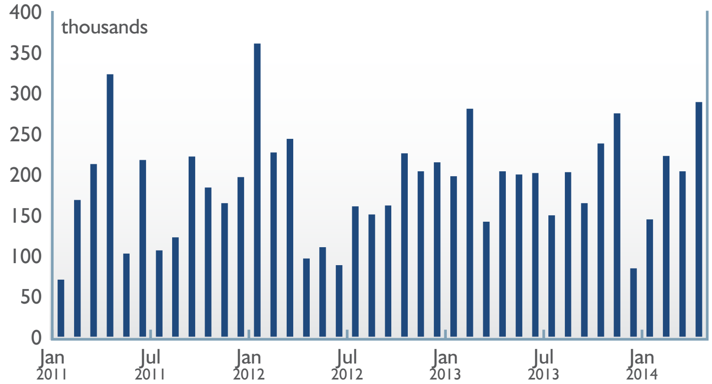


Source: U.S. Bureau of Economic Analysis

Strong gains in employment

The job market gained 288,000 jobs in April and the data for March and February were both revised upwards. The last monthly variation of similar scope dates back to October 2013 (graph). The unemployment rate dipped by 0.4 percentage points in April, reaching 6.3%. This is its lowest level

Monthly variation in non-farm payroll employment
(January 2011 to April 2014)



Source: U.S. Bureau of Labor Statistics

since September 2008, when it stood at 6.1%. At that time, however, the overall job market situation was better: the number of discouraged workers (people who have stopped looking for a job because they are convinced they will not find one) was about half what it is now, and the percentage of long-term unemployed (out of work for more than 27 weeks) was far lower (21.3% versus 35.3%). That said, the job market is clearly improving, and the trend should continue.

The housing market is sputtering

The number of housing starts rose by 2.8% in March compared with the previous month, but was 5.9% below the figure reached in March 2013. Starts of single-family homes were up by 6.0% compared with February, while starts of multiple-dwelling homes fell by 6.1%. As for sales of existing homes, they stayed fairly stable, slipping from 4.60 million units sold in February to 4.59 million units in March. According to the chief economist of the National Association of Realtors, activity in the resale market should be more brisk than that, given the growth in the population. Some observers believe that the difficulties that young people are encountering in the job market may be holding back the formation of households and, consequently, demand for housing. The unemployment rate among those between 16 and 24 years of age, which stood at around 10% prior to the financial crisis, soared to 19.5% in 2010. It has fallen back since then, but in April it was still high – 13% – which supports this hypothesis. Improvement in the job market should, sooner or later, contribute to an acceleration in home sales and housing starts. ■

INTEREST RATES

Back

No change in the key interest rate

On April 16, the Bank of Canada left the target for the overnight rate unchanged. That same day, the central bank released its Monetary Policy Report in which it sets out, in detail, its vision of the global and Canadian economies. Generally speaking, the projections for Canada's real GDP growth are similar to those that the Bank presented three months ago. On the other hand, inflation projections have changed: it is now expected to return to the 2% target sooner, i.e. as early as the first quarter of 2015 (table). This is a consequence of the depreciation of the Canadian dollar and of the anticipated rise in energy prices. Despite this change, forecasters do not expect the central bank to raise the key interest rate before the beginning or middle of 2015. Those expectations could change, however, should inflation reach the 2% target faster than expected. ■

Projections for the Canadian economy

	2013	2014				2015			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (annualized quarterly growth, %)	2.9	1.5	2.5	2.6	2.5	2.5	2.4	2.4	2.3
	(2.5)	(2.5)	(2.5)	(2.5)	(2.6)	(2.5)	(2.5)	(2.3)	(2.2)
Total inflation (%)	0.9	1.3	1.6	1.8	1.9	2.0	2.0	2.0	2.0
	(0.9)	(0.9)	(1.2)	(1.4)	(1.5)	(1.7)	(1.9)	(1.9)	(2.0)

Note: Figures in brackets are the projections presented in the January 2014 edition of the Monetary Policy Report.
Source: Bank of Canada, Monetary Policy Report, April 2014.

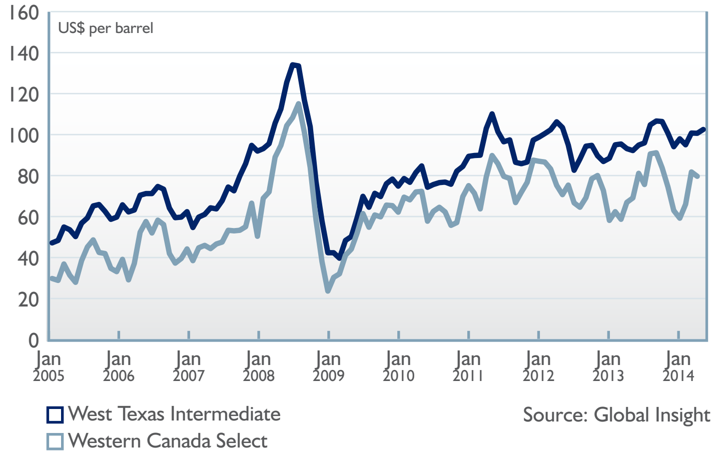
OIL PRICE

Back

The price of oil remains high

The price of crude oil stayed high in April due to the crisis in Ukraine, which is continuing and intensifying. Investors fear that the West may adopt more severe measures against Russia, in particular relating to energy. Approximately 30% of Europe's imports of oil and gas come from Russia. ■

Price of crude oil
(January 2005 to April 2014)



Source: Global Insight

CANADIAN DOLLAR

Back

The Canadian dollar appreciates against the U.S. currency

In April, the Canadian dollar appreciated by 1.1% against the U.S. dollar. This is its sharpest monthly increase since September 2012. This appreciation seems to stem from the fact that the Bank of Canada now expects the inflation rate to move back towards the 2.0% target sooner than previously thought, making a cut to the Canadian key interest rate less likely.

Canada/United States exchange rate
(January 2007 to April 2014)

Source: Bank of Canada

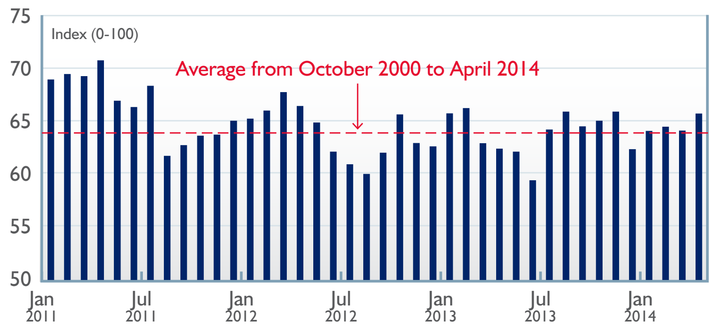
SME CONFIDENCE

Back

Growing confidence among SME owners

The Canadian Federation of Independent Business's Business Barometer Index gained 1.6 percentage points to reach 65.7 in April, its highest level since last November (graph). Among the various sectors, there is not much of a spread between the degree of optimism expressed by business leaders: the sector with the lowest reading (58.8) is housing, while business services shows the highest reading (70.3). From one province to another, the variations are greater. Business leaders in Prince Edward Island are the least confident in the country, and those in Saskatchewan are the most positive. Other optimistic business climate indicators include the percentage of businesses that plan to hire full-time staff in the next three to four months, and the percentage of business owners who plan to invest during that period; both of these now stand at their highest levels since the recession.

Business barometer
(January 2011 to April 2014)



Source : Canadian Federation of Independent Business

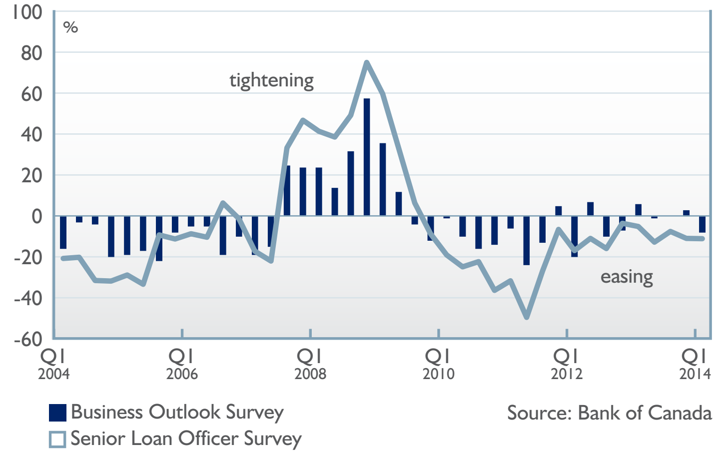
BUSINESS CREDIT CONDITIONS

Back

Business credit conditions eased slightly

Short-term credit granted to businesses by the chartered banks continued to expand in March, while long-term credit dipped slightly. Over the past 12 months, growth in total bank credit granted to businesses has kept waning, but at 7.8% in March, it is still high. According to the Business Outlook Survey and the Senior Loan Officer Survey conducted by the Bank of Canada, the credit conditions facing businesses eased slightly during the first quarter of the year (Graph). ■

Business credit conditions
(2004 Q1 to 2014 Q1, balance of opinions)



Source: Bank of Canada

KEY INDICATORS – CANADA

Back

Key indicators – Canada

	Historical[1]				2013[2]				Latest		Forecast	
	2009	2010	2011	2012	Q1	Q2	Q3	Q4			2014	2015
Real GDP (% growth)	-2.7	3.4	2.5	1.7	2.9	2.2	2.7	2.9	Feb	0.2	2.2	2.5
Machinery and Equipment Expenditures (% growth)	-21.2	10.6	8.6	5.2	-0.7	-0.4	-4.3	3.2			2.9	5.8
Pre-Tax Corporate Profits (% growth)	-45.4	61.6	16.6	-8.2	25.7	-28.0	36.1	5.7			5.7	5.9
Industrial Production (% growth)	-11.0	6.0	3.9	0.9	5.8	-2.2	3.6	6.5	Feb	0.9	2.7	2.6
Industrial Product Prices (% growth)	-3.5	1.0	-2.3	1.1	3.8	-2.7	1.5	-0.6	Mar	0.4	1.7	1.8
Non-Residential Construction (% growth)	-19.4	17.3	12.9	6.9	2.8	-1.0	2.6	-4.0				
Housing Starts (' 000 units)	148	192	194	215	172	190	194	194	Apr	195	179	175
Personal Expenditures (% growth)	0.3	3.5	2.3	1.9	1.0	3.5	2.4	3.1			2.3	2.2
Consumer Price (% growth)	0.3	1.8	2.9	1.5	1.6	-0.1	1.9	-0.9	Mar	0.6	1.6	2.0
Employment (% growth)	-1.6	1.4	1.5	1.2	0.9	1.2	0.8	0.9	Apr	-0.2		
Unemployment Rate (%)	8.3	8.0	7.4	7.3	7.1	7.1	7.1	7.0	Apr	6.9	6.8	6.5
SMEs Confidence Index (CFIB)	57.7	66.7	66.4	63.9	64.9	61.3	64.8	64.4	Apr	65.7		
Manufacturers Confidence Index (CFIB)	56.0	68.5	67.3	66.7	65.6	58.3	65.4	65.8	Apr	65.8		

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.