BDC
Entrepreneurs first

economic LETTER

JULY-AUGUST 2014

CANADIAN BUSINESSES IN THE DIGITAL AGE

Digital technology has revolutionized the ways in which we communicate, work and play. Not only has it changed people's lifestyles, but it has also changed the way businesses operate. For instance, nowadays, the vast majority–89 % of Canadian firms–use the Internet.

However, the results of the *Survey of Digital Technology and Internet Use* conducted by Statistics Canada reveal that the use of information and communications technologies (ICT) varies greatly, depending on the size of the firm.[1] All things being equal, far fewer small firms, compared with large and medium-sized enterprises, have a company-wide computer network or a system for managing client and supplier relations, for example. This is not surprising, since few of them really need one due to their small size. On the other hand, it is somewhat more worrisome to note that only 42% of small firms have a website (see table, below).[2] To an increasing degree, buyers tend to "shop around" for products and services online, so a business without a website will be ignored by a significant proportion of its potential clientele.

E-commerce is still of limited scope in Canada, but it is expanding quickly. Last year, 13% of private Canadian firms were engaged in online sales, for a total value of $136 billion, 12% higher than the year before. Overall, nearly one quarter (23.6%) of these firms' sales took place online, mainly in Canada (79%). The percentage of firms engaged in online sales increases in correlation with the size of the firm, ranging from 12% of small firms to 28% of large firms. For medium-sized firms, that percentage is 18%, but the proportion of sales that they carry out online is higher: one third of total sales.

E-commerce varies considerably from one industry to another. The graph below shows that private educational services, the information and cultural sector and the arts, entertainment and recreation sector are the industries with the highest percentage of firms engaged in online sales. But, as a group, these three sectors accounted for only 6% of total online sales in 2013. Wholesale trade represents the lion's share of e-commerce with 34% of total online sales, followed by manufacturing (17 %) and retail trade (10 %).▼

1 In this survey, the size of firms is defined as follows: small businesses have 0 to 19 full-time employees; medium-sized firms have 20 to 99 full-time employees, except those in the manufacturing sector, which have 20 to 499 full-time employees; large companies have 100 or more full-time employees, except those in the manufacturing sector, which have 500 or more full-time employees.

2 The fact that, in this survey, small businesses include self-employed workers (0 employees) accounts in part for the low percentage of small businesses that have a website.

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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 July 12. Reliance on and use of this information is the reader's responsibility.

A few statistics from the *Survey of Digital Technology and Internet Use*

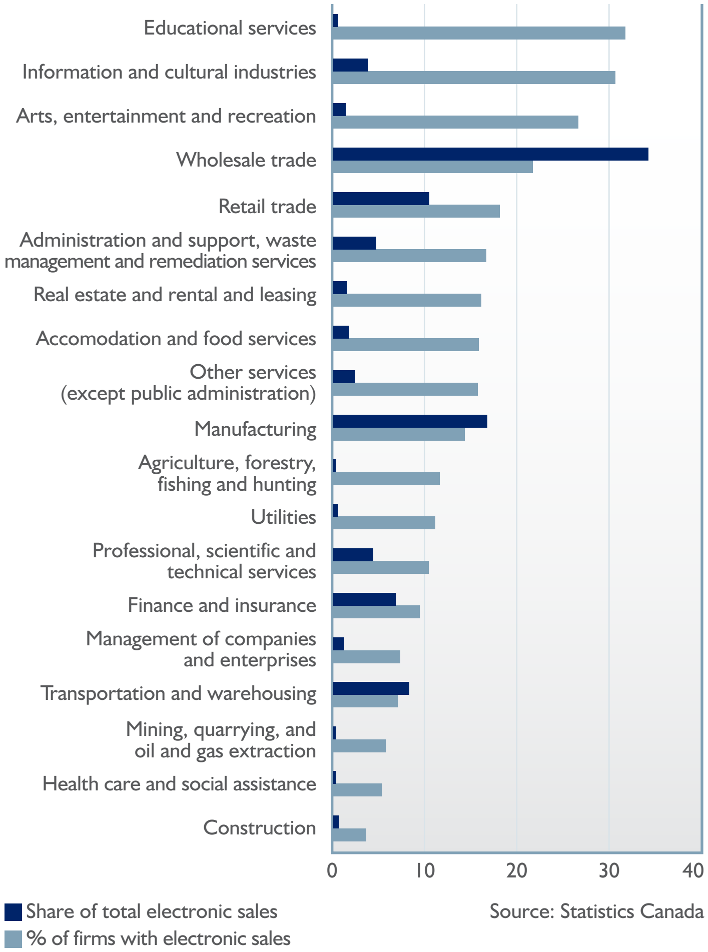
	Total	Small	Medium	Large
Firms that use the Internet (%)	89.1	88.1	98.4	99.9
Firms that have a website (%)	46.2	42.3	83.3	91.4
Firms engaged in online sales (%)	12.8	12.1	18.1	28.3
% of online sales in relation to total sales	23.6	22.5	32.4	21.8
% of online sales in Canada	79.1	82.1	78.7	79.7
% of online sales in the United States	14.5	12.7	16.3	14.4
% of online sales in other countries	5.6	5.3	5.1	5.9

E-commerce is expanding in Canada but is still modest compared with the United States. According to U.S. Census Bureau data, online retail sales accounted for 5.2% of total retail sales in the United States in 2012. In Canada, the proportion of retail sales carried out online is lower: less than 3.0%.[3]

While the computer is by far the digital device most commonly used (by 85% of firms in 2013), more and more firms (60% in 2013, up from 53% in 2012) also use mobile devices connected to the Internet, such as smartphones and tablets. Although nearly all firms use ICT in one form or another, there are still some obstacles hindering its broader integration. For medium-sized and large firms, the cost of acquiring and setting up the technology is the main obstacle, while for small firms, it is the lack of technical expertise and specialized personnel in-house that is restricting its integration. Furthermore, one fifth of firms lament the lack of proof of a good return on investment in the technology, while another fifth expresses concerns about security and privacy issues associated with its use. Those concerns are mentioned mainly by large firms, 14% of which reported that they had fallen victim to a cyber security breach in 2013.

In short, the Statistics Canada survey shows that Internet use has become a common practice at the majority of Canadian businesses. The adoption of other digital technologies varies according to the size of the business and the industry to which it belongs. Smaller firms are slower to adopt such technologies, as they generally lack the means and the expertise that larger firms have at their disposal.

Percentage of private firms with electronic sales and share of total electronic sales, by industry (2013)



Source: Statistics Canada

3 If we take the value of online retail sales reported in the Survey of Digital Technology and Internet Use and divide it by total retail sales in Canada in 2012, we obtain a proportion of 2.9%. However, according to the Annual Retail Trade Survey, the proportion of retail sales carried out online is 1.5%. Therefore, we can assume that the real figure is between 1.5% and 2.9%.

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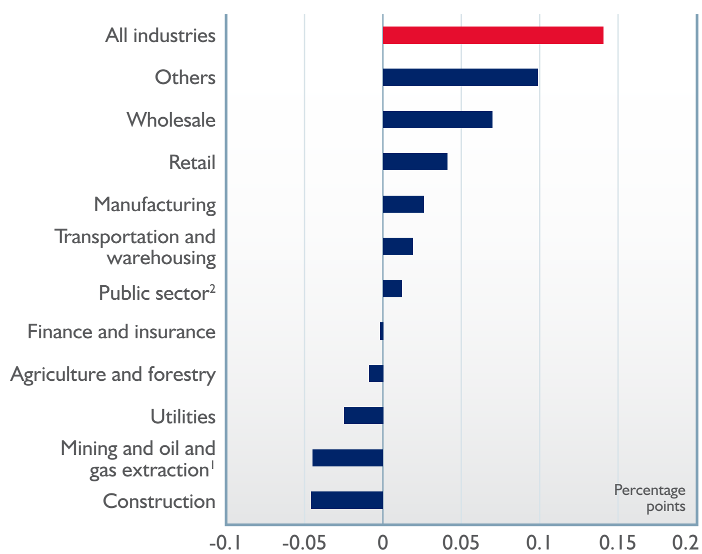
The second quarter is starting off with rather modest real GDP growth. After the sluggish growth in the first quarter, we were hoping for something better. Furthermore, the labour market situation is discouraging: job creation in the past 12 months has been practically at a standstill. On the bright side, a surge in exports in May is a positive development and a good sign for the future. In fact, we expect that international trade will be one of the main contributors to economic growth in 2014.

Sluggish GDP growth

Real GDP nudged up by a mere 0.1% in April compared with the previous month. Production increases in wholesale and retail trade, manufacturing, transportation and warehousing and some services, in particular accommodation and food services and professional services, were partly cancelled out by production pullbacks in mining and oil and gas extraction, construction, utilities and the agriculture and forestry sector (Graph). We should keep in mind that real GDP growth in the first quarter was just 1.2%. Growth will have to accelerate in the months ahead in order for the consensus forecast, 2.2% for the 2014, to be achieved.

Main industrial sector's contribution to the percent change in GDP in April 2013



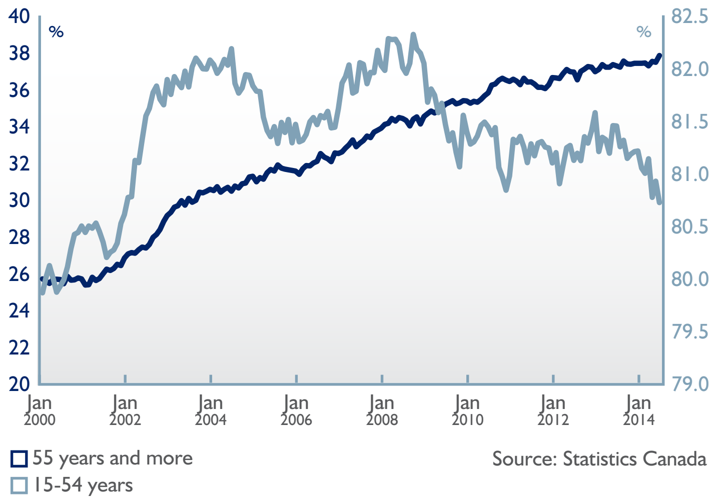
1. Includes quarrying
2. Education, health and public administration

Source: Statistics Canada

Employment stagnates

A gain of 33,500 full-time jobs and a loss of 43,000 part-time jobs meant that employment was down by 9,500 jobs in June compared with the previous month. Employment has been stagnating for several months now: between June 2013 and June 2014, it rose by just 0.4%, whereas in the preceding 12 months it expanded by 1.4%. As for the unemployment rate, it rose by 0.1 % in June, reaching 7.1%. Looking at the data broken down by age group, we note a decline of 69,500 jobs in the population aged 15 to 54 in June, which is offset to a large extent by a gain of 60,000 jobs among those aged 55 and over. The labour force participation rate of the population aged 55 and over has been increasing steadily since the start of the 2000s, and this trend is likely to continue (Graph). On the other hand, the participation rate of those aged 15 to 54 plunged at the beginning of the recession and has not turned the corner since then.

Participation Rate, by age group
(January 2000 to June 2014)

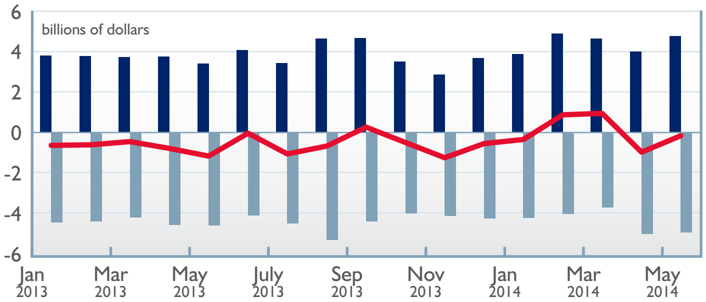


Source: Statistics Canada

Exports advance strongly

Exports surged by 3.5% in May compared with the previous month. Imports expanded at a slower pace than did exports, at 1.6%, causing the trade deficit to shrink from $961 million in April to $152 million in May. Exports of vehicles and auto parts rose for the fourth month in a row, posting solid growth of 9.8%. Energy products and consumer goods also contributed to the expansion of exports in May, with monthly growth of 3.4% and 4.4% respectively. Canada's trade surplus with the United States climbed from $4.0 billion in April to $4.8 billion in May, while its trade deficit with other countries fell back slightly, from $5.0 billion in April to $4.9 billion in May (Graph). In terms of volume, exports increased by 3.8% in May, and imports by 2.2%.

Canada Trade Balance with the United States and with the rest of the other countries (January 2013 to May 2014)



United States
Countries other than the United States
Total

Source: Statistics Canada

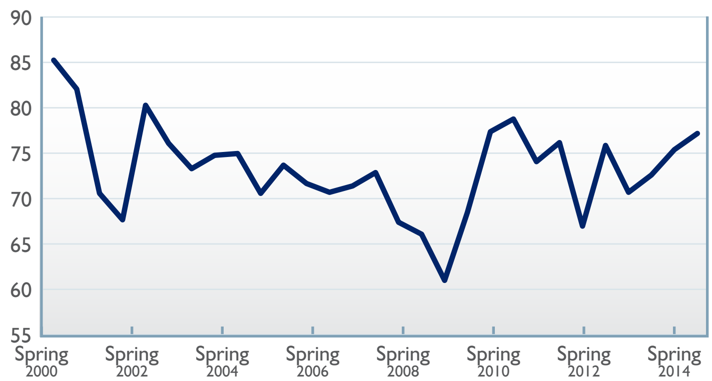
Housing starts creep up

Housing starts ticked up by 0.6% in June compared with the previous month. That increase is mainly attributable to the single-family dwelling segment, where starts rose by 0.9%. The multiple-dwelling segment saw a meagre gain of 0.1%. If we look at the six-month rolling average, the housing start trend has been stable since March 2014 but is down from where it was in the six months before that. These numbers are consistent with forecasts from the Canada Mortgage and Housing Corporation, which anticipates a soft landing by Canada's homebuilding sector in 2014.

Exporter confidence builds

The Trade Confidence Index (TCI), compiled by Export Development Canada based on a survey conducted twice a year, measures Canadian exporters' perceptions of international business outlooks for the next six months. The spring 2014 survey shows that exporters are increasingly confident: the TCI gained 1.8 points between the fall of 2013 and the spring of 2014, rising from 75.4 to 77.2 (Graph). The majority of respondents are anticipating an increase in export sales in the next six months, thanks to the past depreciation of the Canadian dollar and the strengthening of the U.S. economy. ■

Trade Confidence Index
(Spring 2000 to Spring 2014)



Source: Export Development Canada

UNITED STATES

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The first-quarter contraction in real GDP could well jeopardize the anticipated acceleration in economic growth in 2014. But we must not jump to conclusions: a portion of the sluggishness in economic activity in the first quarter is due to an exceptionally severe winter. The healthy performance by the labour market gives reason to hope for a rebound in growth in the second quarter.

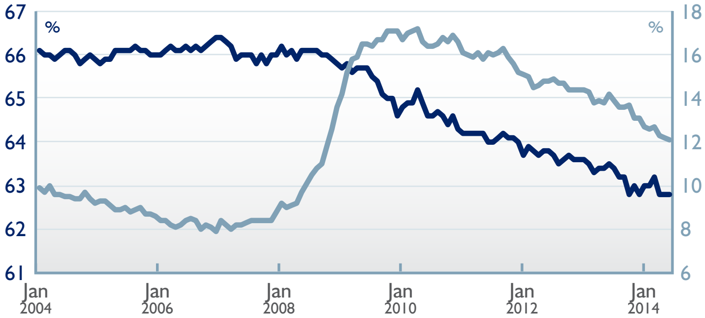
Real GDP growth is revised downwards once again

According to the third estimate by the Bureau of Economic Analysis (BEA), real GDP contracted at an annual rate of 2.9% in the first quarter of 2014. Remember that initially, at the end of April, the BEA estimated that real GDP growth was nil in the first quarter, while the second estimate, at the end of May, showed a decline of 1.0%. So here we have another substantial downwards revision. The culprits are consumption growth, which turned out to be limper than was first thought, and the decline in exports, which was more pronounced.

Employment continues to make gains

Non-farm payroll employment expanded by 288,000 jobs in June, and the April and May data were revised upwards by 7,000 and 22,000 jobs, respectively. The unemployment rate dipped by two tenths of a percentage point, reaching 6.1%, its lowest level since September 2008. The labour market is undeniably improving from month to month. That said, it is important to put these gains into context. Despite making steady progress in the past 45 months, employment has only just returned to where it stood in January 2008, before it took a nosedive. Also, the jobless rate, at 6.1%, appears to be entirely acceptable; but the reality is different, because that number camouflages the fact that the participation rate plunged at the beginning of the financial crisis and has not picked up since then (Graph). If we take into account the people who are working part time rather than full time, not of their own accord, and those who are standing on the sidelines (including discouraged workers, i.e. those who have stopped looking for work because they are convinced they will not find any), the June unemployment rate is 12.1% (Graph). That said, that underemployment rate has also declined since the beginning of 2010 and should continue to do so in the months to come. ▼

Participation Rate and Underemployment Rate*
(January 2004 to June 2014)



Participation Rate
Underemployment Rate

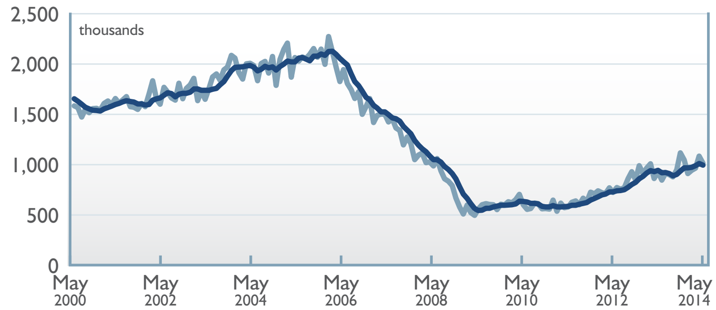
Source: U.S. Bureau of Labor Statistics

* Unemployment rate adjusted to take into account persons marginally attached to the labor force and those who work part-time for economic reasons.

Housing starts pull back but home sales climb

Housing starts fell by 6.5% in May compared with the previous month. They were down by 5.9% in the single-family dwelling segment and by 8.3% in the multiple-dwelling segment. Despite that decline, their long-term trend, according to the six-month rolling average, is still positive (Graph). Meanwhile, home sales surged in May, posting their sharpest month-over-month increase in the past three years: 4.9%. Real estate activity was lacklustre in the first quarter due to inclement weather, among other things. The May data confirm the rally that was expected. ■

Housing Starts
(May 2000 to May 2014)



Housing starts
6-month moving average

Source: U.S. Census Bureau

INTEREST RATES

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The key interest rate should hold steady at 1.0% for the rest of this year

The Bank of Canada will announce its next key interest rate decision on July 16. At the same time it will release its Monetary Policy Report containing its new projections for the economy and for inflation. Forecasters are unanimously predicting that the key interest rate will stay unchanged at 1.0% on July 16, where it has stood for nearly four years now (since September 2010). None of them are anticipating a rate hike before 2015. ■

OIL PRICE

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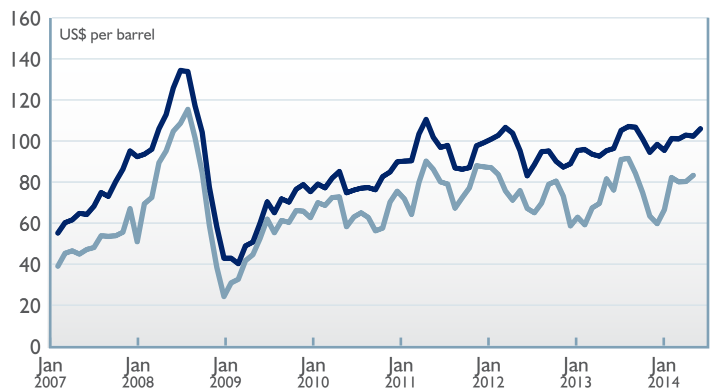
Violence in Iraq triggers a spike in crude oil prices

The price of crude oil shot up in the middle of June following a Jihadist attack on Iraq's main oil refinery. This refinery does not supply oil to customers outside the country, so its impact on exports of Iraqi oil is limited. However, the violence that is rocking Iraq risks compromising oil production in the longer term, and this worry drove the price of oil up sharply. The southern part of the country, where the great majority of oil fields and pipelines used to export the country's oil are located, has so far been spared, and the Iraqi government has managed to drive the insurgents into the northern and western regions. Since no disruption in the supply of oil was observed, the price of crude started falling back at the end of June… especially since Libya, whose oil production was paralyzed for a year, has announced that its oil exports will return to normal in the weeks ahead. ■

Crude Oil Price
(January 2007 to June 2014)



West Texas Intermediate
Western Canada Select

Source: Global Insight et Alberta Office of Statistics and Information

CANADIAN DOLLAR

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The loonie appreciates further against the greenback

The Canadian dollar keeps appreciating against the U.S. dollar. This is partly due to the upwards trend in Canada's inflation rate: in May it surpassed the Bank of Canada's 2.0% target, reaching 2.3%. Strong employment growth in the United States in June also contributed to the loonie's appreciation. This lively job growth suggests that the U.S. economy is getting back on its feet. Since Canadian economic outlooks are closely tied to those of the United States, those statistics are a very good omen as far as Canada is concerned. Stronger inflation and improving Canadian economic outlooks boosted expectations of a sooner-than-expected interest rate hike, and contributed to the loonie's appreciation.

Canada/United States Exchange Rate
(January 2007 to June 2014)

Source: Bank of Canada

SME CONFIDENCE

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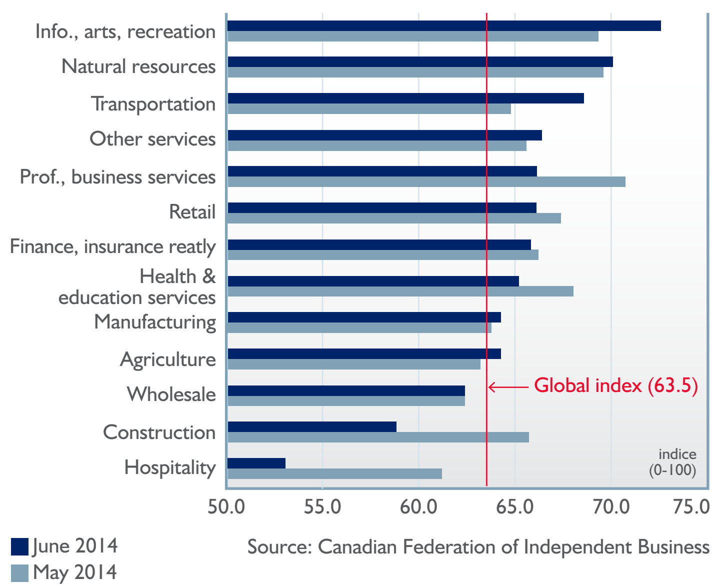
SME owners' confidence slips

In June, the Business Barometer Index compiled by the Canadian Federation of Independent Business saw all the gains it had recorded in the past two months wiped out; it dropped from 67.1 in May to 63.5 in June. SME owners' confidence waned in five sectors, especially in accommodation and construction, where the index now stands significantly below the national average. Looking at the regions, despite monthly variations, the index is maintaining the same profile: confidence is still stronger in the western provinces and Newfoundland and Labrador than in the other Canadian provinces.

Business Barometer, by sector
(May and June 2014)



Source: Canadian Federation of Independent Business

BUSINESS CREDIT CONDITIONS

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Business credit conditions have eased further

According to the *Business Outlook Survey* and the *Senior Loan Officer Survey* conducted by the Bank of Canada, business credit conditions eased once again in the second quarter, compared with the previous quarter (Graph). Businesses are benefiting from the competition being waged between the lending institutions. Firms that are in an excellent financial position, in particular, have been offered more favourable credit rates and terms and conditions in the past three months. Furthermore, bank credit is continuing to expand: in May, short-term credit granted to businesses by the chartered banks rose by 1.1% compared with the previous month, while long-term credit ticked up by 0.5%.■

Business Credit Conditions
(2004 Q1 to 2014 Q2, balance of opinions)

Business Outlook Survey
Senior Loan Officer Survey

Source: Bank of Canada

KEY INDICATORS—CANADA

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Key indicators–Canada

	Historical[1]				2014[2]				Latest		Forecast	
	2010	2011	2012	2013	Q1	Q2	Q3	Q4			2014	2015
Real GDP (% growth)	3.4	2.5	1.7	2.0	1.2				Apr	0.1	2.2	2.5
Machinery and Equipment Expenditures (% growth)	10.6	8.6	5.2	-0.2	-5.8						1.0	5.8
Pre-Tax Corporate Profits (% growth)	61.6	16.6	-8.2	-0.3	50.7						7.8	5.6
Industrial Production (% growth)	6.0	3.9	0.9	1.8	4.9				Apr	-0.2	3.6	2.7
Industrial Product Prices (% growth)	1.5	6.9	1.1	0.4	13.0				May	-0.5	2.5	2.0
Non-Residential Construction (% growth)	17.3	12.9	6.9	2.2	0.4							
Housing Starts (' 000 units)	192	194	215	-13	175	197			Jun	198	182	177
Personal Expenditures (% growth)	3.5	2.3	1.9	2.4	1.2						2.2	2.2
Consumer Price (% growth)	1.8	2.9	1.5	1.0	2.8				May	0.5	1.8	2.0
Employment (% growth)	1.4	1.5	1.2	1.3	0.4	0.3			Jun	-0.1		
Unemployment Rate (%)	8.0	7.4	7.3	7.1	7.0	7.0			Jun	7.1	6.9	6.6
SMEs Confidence Index (CFIB)	66.7	66.4	63.9	0.0	64.2	65.4			Jun	63.5		
Manufacturers Confidence Index (CFIB)	68.5	67.3	66.7	63.8	64.9	64.6			Jun	64.2		

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.