



Foreign Affairs, Trade and  
Development Canada

Affaires étrangères, Commerce  
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Canada

# CANADA'S STATE OF TRADE

## Trade and Investment Update 2013





# Canada's State of Trade

Trade and Investment Update – 2013

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## ABOUT THIS DOCUMENT

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*Canada's State of Trade – 2013* was prepared under the direction of Mykyta Vesselovsky of the Office of the Chief Economist of the Department of Foreign Affairs, Trade and Development (DFATD). The report was written by Mykyta Vesselovsky, with contributions provided by Crystal Arnburg, David Boileau, Rick Cameron, Shenjie Chen, Terrence Cowl, Mitra Rostami and Motria Savaryn. Statistical assistance was provided by Crystal Arnburg, Nancy Blanchet, Maureen Francoeur, Raphaëlle Gauvin-Coulombe, Mitra Rostami and Motria Savaryn. Comments at the drafting stage were provided by André Downs, Chief Economist, Office of the Chief Economist.

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## Acronyms

BOC	Bank of Canada
BOP	Balance of Payments
CDIA	Canadian Direct Investment Abroad
CGE	Computable General Equilibrium
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
CUSFTA	Canada United States Free Trade Agreement
DFAIT	Department of Foreign Affairs and International Trade
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
G-7	Group of Seven
GDP	Gross Domestic Product
HS	Harmonized System
I/O	Input /Output
IMF	International Monetary Fund
LAC	Latin America and Caribbean
MENA	Middle East and North Africa
NAFTA	North American Free Trade Agreement
NIE	Newly Industrialized Economies
OECD	Organization for Economic Co-operation and Development
RAM	Random Access Memory
ROW	Rest of World
SITC	Standard International Trade Classification
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
US	United States
WTO	World Trade Organization



## The Honourable Ed Fast, Minister of International Trade



I am pleased to present the 2013 edition of Canada's State of Trade. This report provides an overall assessment of Canada's recent international commercial performance and examines some of the key trends and developments in international trade and investment during the past year.

As the recovery from the global economic crisis continued in 2012, Canada once again proved that it remains one of the most stable economies in the world. Since 2009, Canada consistently performed at the top of the G-7 in the areas of job creation, economic growth and financial stewardship. As a trading economy, Canada has considerable exposure to the economic difficulties in other regions—nevertheless,

Canadian businesses and workers have adapted to and overcome those challenges. Between July 2009 and May 2013, our economy created over a million new jobs, most of them full-time. Our employment and our GDP growth during the recovery are second to none in the G-7. Our banking system is consistently rated the best in the world by the World Economic Forum, and our economy is rated best for business in the G-20 by *Forbes* magazine.

To continue outperforming its peers during the global recovery, Canada needs to build on these strengths and conduct a sound, focused economic policy. This is why trade and investment abroad remain among this government's highest priorities. Economic Action Plan 2013 builds on the strong foundation laid in the previous years to strengthen the economy, create jobs and promote growth while maintaining a low-tax environment. We are better equipping Canadians with the skills and training they require to obtain high-quality, well-paying jobs in the global marketplace, and we are helping businesses to succeed in the global economy by enhancing the conditions for creating and growing businesses, to increase and diversify our exports, and to develop our natural resources in a safe, responsible and secure way. Further, we are working to improve our trade and investment relationships with crucial, fast-growing economies and to strengthen Canada's fiscal position by achieving a balanced budget by 2015.

As part of the most ambitious trade-expansion plan in Canadian history, we are reaching out toward the largest and most dynamic economies: both developed and emerging. Canada is engaged in negotiations with large and fast-growing markets such as the European Union, Japan, India, and the countries that comprise the Trans-Pacific Partnership. Our trade and investment flows

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with the United States—our top trading partner—are being enhanced with the Joint Action Plan on Perimeter Security and Economic Competitiveness and the Joint Action Plan on Regulatory Cooperation. In less than six years, Canada has concluded free trade agreements with nine countries: Colombia, Honduras, Jordan, Panama, Peru and the European Free Trade Association member states of Iceland, Liechtenstein, Norway and Switzerland. In that period, Canada has concluded or brought into force foreign investment promotion and protection agreements with 17 countries and is actively negotiating with 14 others.

As you read *Canada's State of Trade 2013*, the story of the recovery of Canada's international trade and investment in the aftermath of the global crisis will emerge. A big part of that story is how quickly our trade has been changing in those difficult economic times—and how adaptable and resilient Canadian firms and workers have been in the face of this change. Our government is proud to lead their efforts to keep this country economically strong, internationally competitive and a prime destination for international investment.



**The Honourable Ed Fast**  
Minister of International Trade  
and Minister for the Asia-Pacific Gateway

# Executive Summary

The global financial and economic crisis of 2008–09 is gradually becoming history, but the world economy continues to travel down a bumpy road. The years that elapsed since the crisis have been full of optimistic forecasts and disappointed expectations. Strong recovery, propelled by inventory restocking and concerted fiscal and monetary action of the governments worldwide, lasted less than a year. Since 2010, global growth has been on a downward trend, which continued in 2012. The damage done by the crisis has not been fully repaired; high unemployment persists in most developed countries, with their economies and trade moving sluggishly. Both public and private sources of demand have not been instrumental in fuelling a strong recovery. Fiscal retrenchment throughout the advanced world is constraining government actions, and an uncertain investment climate is limiting private investment; both are preventing robust recovery for employment.

Continuing uncertainty in the post-crisis landscape of 2012 had many sources. The eurozone continued to generate financial and economic stress around the world as the crisis there is far from resolved. While the fiscal position of Italy and Spain was, for the moment, stabilized by a decisive intervention of the European Central Bank (ECB), the previously resilient German economy succumbed to the downturn. Further, the declared priority of shoring up fiscal balances across Europe became ever harder to meet as the stagnating output dried up tax revenues.

The long-term solvency of the periphery within the eurozone depends on finding a set of fiscal and monetary policies consistent with economic, political and social stability of all the euro members. A solution along these lines in Europe would go far toward restoring confidence across the developed economies.

The United States was another source of uncertainty in 2012. While the election stabilized the political situation and ensured there will be no repeal of major legislation of President Obama's first term, the tug-of-war between the House, the Senate and the President continued. Sequestration is expected to slow the U.S. recovery, and a potential fiscal crisis still seems to be around every corner. Meanwhile, Japan adopted a boldly expansive fiscal and monetary policy to find its way out of the crisis. Its success or failure may turn out to be crucial for the world economy, but the main risks of its policy is that Japan hardly has fiscal room to try anything else in the adverse scenario. Political instability in the parts of the Middle East and the geopolitical risks associated with Iran and North Korea persisted.

On the positive side, the U.S. economy showed some signs of harnessing its immense potential for recovery as the labour and housing markets started picking up the pieces in which they were left by the crisis. China avoided a hard landing and is expected to rebalance its economy toward consumer demand. Credit and economic activity were also increasing in many

developing economies, particularly Asian and Latin American, and equity and labour markets were booming.

The world's real GDP grew by 3.2 percent in 2012, down from 4.0 percent in 2011. Growth in the advanced economies slowed down to 1.2 percent in 2012 from 1.6 percent in 2011. Developing economies also decelerated, from 6.4 percent in 2011 to 5.1 percent in 2012. The United States was the growth leader among the major developed economies; in the developing world, some of the "second generation" emerging markets did very well, such as Indonesia, the Philippines, Malaysia and Thailand. The German economy slowed to 0.9 percent in 2012 after 3.1-percent growth in 2011; output in France stagnated, and the eurozone as a whole slid into a recession with growth of negative 0.6 percent in 2012. Japan followed up a 0.6-percent contraction in 2011 with 2.0-percent growth in 2012, but still managed to slip into its third technical recession in five years in mid-year.

Developing Asia's economies expanded 6.6 percent in 2012, a deceleration from the 8.1-percent rate of 2011. China led the slowdown with a 7.8-percent growth in 2012 following 9.3-percent growth in 2011. India slowed down even more, ending the year with 4.0-percent growth: barely half of its 7.7-percent growth in 2011. The economies of the Middle East and the North Africa region accelerated to 4.8-percent growth in 2012, as did the economies in Sub-Saharan Africa. The Latin America and Caribbean region was next, with 3.0-percent growth, while Brazil's economy faltered, growing only 0.9 percent in 2012 after 2.7-percent growth in 2011. Emerging Europe slowed down abruptly, from 5.2 percent in 2011 to 1.6 percent in 2012.

Amidst the harsh environment of the uneven and uncertain global recovery of the last few years, Canada's economy has continued its doggedly strong performance. Real economic activity in Canada expanded by 1.8 percent in 2012, after 2.6-percent expansion a year earlier; growth was solid and based on leveraging the fundamental strengths of the economy. Economic activity grew in all four quarters of the year; domestic strength combined with the recovery taking hold in the United States in the second half of the year were the main pillars of growth. New housing construction showed double-digit growth, business investment continued on its robust growth path, while resource prices stagnated and inflation was subdued. The only major concern, the rising household debt-to-income ratio, in conjunction with the upward path of housing prices, hit a record of 165 percent at the end of the year, indicating potential vulnerability should an external shock result in deleveraging.

Canada's performance throughout the recovery so far has been the best in the G-7 in both employment and real GDP growth, with over a million new jobs created since the employment trough—with an overwhelming number of those jobs full-time. The employment picture improved in most regions, with over 300,000 net new jobs created during 2012. The unemployment rate improved by 0.4-percent-age point during the year—from 7.5 percent in December 2011 to 7.1 percent in December 2012. The average unemployment rate for the year as a whole declined less substantially, from 7.5 percent in 2011 to 7.3 percent in 2012.

Eight out of ten provinces and all territories reported positive real economic growth in 2012. Business expenditures drove most of the growth in GDP, with consumer expenditures

close behind. Government expenditures contracted, dragged down by decreased government investment, and contributed negatively to GDP for the first time since 1997; contribution from net trade was also negative. Inflation rose just 1.5 percent in 2012, nearly halving from 2.9 percent in 2011, largely due to moderation in prices of gasoline and food. The Canadian dollar was mostly at parity against the U.S. dollar in 2012, and behaved rather smoothly throughout the year; its average valuation during the year was about 1 percent lower than in 2011.

The volume of world trade slowed down sharply in 2012 to 2.0 percent (in real terms). Nominal trade values (measured in U.S. dollars) expanded just 0.2 percent in 2012, compared to 20 percent in 2011, as prices of traded goods declined. Real export growth in developed economies slowed down the most, dropping to 1.0 percent in 2012 from 5.1 percent in 2011, while the developing world recorded an increase of 3.3 percent in 2012—slower than the 5.4-percent growth in 2011.

Against this background, Canada's economic and trade challenges can be better understood. In Canadian dollar terms, Canada's exports of goods and services to the world expanded 1.1 percent in 2012. Growth was led by goods exports at 1.3 percent; services exports slowed down, showing 0.3 percent growth. On the import side, imports of goods and services advanced 3.6 percent, with growth in imports of goods at 4.1 percent and growth in imports of services at 1.7 percent.

Increased merchandise trade with the United States was the highlight of 2012, as the secular decline in U.S. shares of Canadian merchandise exports and imports was reversed. The

improving economic picture south of the border, reviving housing markets and the successful restructuring of the automotive sector have been the major drivers behind this increase. This along with the developing energy boom in the United States, driven by the practical applications of developments in horizontal drilling and hydraulic fracturing, serves as a reminder of the strength and importance of the United States as Canada's top commercial partner.

By sector, exports in six of the major goods sectors expanded and declined in the other five. Most of the perceived slowdown in the exports of goods was due to falling export prices. In particular, this was true of the exports of energy products, which increased 7.1 percent in real terms, but rose only 1.5 percent in nominal terms as the prices fell 5.2 percent. The motor vehicles and parts sector experienced the biggest growth, with exports up 14.0 percent in real terms. On the import side, motor vehicles and parts also dominated the gains with a 9.8-percent increase in real terms—illustrating the interdependence of exports and imports in a global value chain-based economy.

Exports of services grew marginally, while imports increased slightly faster. Exports and imports of transportation services were stable in 2012, while travel and tourism services continued to drive Canada's deficit in this category as Canadians spent far more abroad than foreigners spent in Canada. Trade in commercial services changed little, extending Canada's trade surplus in that category into its third year.

In a bad year for global investment, global inflows declined by 18.2 percent, with inflows into developed economies declining by almost a third and overtaken, for the first time, by inflows into developing economies. Global greenfield

investment fell by a third to its lowest level ever recorded. Against this background, Canada performed very well on the investment front. Canada was one of the few countries where foreign direct investment (FDI) inflows increased, up 9.5 percent. Outflows of Canadian direct investment during the year 2012 grew 7.4 percent. Financial flows rose to all destinations but the EU; by contrast, FDI inflows into Canada from the EU increased considerably.

The stock of Canadian direct investment abroad grew 5.5 percent in 2012. Investment expanded most in traditional sectors of interest to Canadians abroad—finance and insurance; mining and oil and gas extraction; and management of companies and enterprises. The stock of foreign investment in Canada expanded slightly faster at 5.8 percent, with less than one third of

the increase going to the manufacturing sector and the rest spread broadly between mining and oil and gas extraction; transportation and warehousing; management of companies and enterprises; and construction. Canada's net direct investment asset position improved slightly to \$77.7 billion in 2012.

Taken as the sum of all of its components, Canada's current account deficit widened by \$13.7 billion in 2012, as a result of the \$12.8-billion deterioration in the goods trade balance and the \$1.6-billion deterioration in the services trade balance. The primary income deficit shrunk slightly, while the secondary income deficit slightly widened. The result was a widening deficit, from \$48.5 billion in 2011 to \$62.2 billion in 2012. ■

# Global Economic and Trade Performance

## Overview and Prospects for the Global Economy

The long and winding road to recovery from the global financial and economic crisis of 2008-09 continued in 2012 with mixed success. Looking back at these past few years, the initial recovery from the worst effects of the shock took place in the second half of 2009 and the first half of 2010, with above-trend global growth. Since then, global growth has remained weak and unsteady. Despite the hopeful but temporary surges in the third quarter of 2011 and first quarter of 2012, growth has petered out as quickly as it came, and extended weakness returned, dashing the associated hopes for a quicker recovery starting from these points. Overall, a downward trend in global growth has set in that is constantly expected to be broken in a year or two, but without success so far.

High unemployment, an uncertain business investment climate, and fiscal retrenchment have become hallmarks of developed countries around the world. While the intervention by the European Central Bank (ECB) has stabilized Italy's and Spain's fiscal positions, the embers of the eurozone sovereign debt crisis continue to smolder and break out into flames sporadically across the European periphery, as evidenced by the Cypriot banking crisis in the spring of 2013. The last quarter of 2012 brought another slowdown to most advanced economies, including the United States, Germany and Japan. The latter has just emerged from its

third recession in five years. As far as global uncertainty is concerned, confidence has failed to improve during the year—while the situation has stabilized in Libya, the civil war in Syria continues unabated, North Korea is multiplying risks in East Asia and serious questions are raised about the Chinese economy's ability to maintain its rate of growth and fulfill the increasing expectations thrust upon it as the engine of world growth and recovery.

The world's real GDP growth decreased from 4.0 percent in 2011 to 3.2 percent in 2012 and is expected to remain at a similar level of 3.3 percent in 2013 before finally rising back to 4.0 percent in 2014. IMF noted that the advanced economies as a whole had a weak start in 2013, but activity is expected to grow through the year, led by the United States. The year 2012 was highlighted by two large threats to the global economy—the potential breakup of the eurozone and a fiscal crisis in the United States. These have been successfully prevented, although permanent solutions have not yet been found. Looking into prospects for 2013, the outcome of sequestration in the United States is now dragging down growth, and the recession in Europe has now spread to the core countries. On the positive side, activity in the developing economies is picking up, with booming equity markets, renewed confidence, and buoyant labour markets.

Growth in major advanced economies slowed from 1.6 percent in 2011 to 1.2 percent in 2012. The slowdown was largely caused by the



recession in the eurozone. The sovereign debt crisis also made a return appearance, briefly driving the long-term borrowing costs for Spain and Italy above 6 percent and increasing uncertainty about the common currency area. Growth in France evaporated, German growth was brought low and Italy's growth

went sharply negative. Newly industrialized economies (NIEs) also lost steam, falling to unusually low rates of growth between 1 and 2 percent. Japan slipped in and out of recession and has staged somewhat of a recovery, and the United States has seen its growth accelerate, but these movements were not enough to offset

<b>TABLE 1-1</b>						
Real GDP Growth (%) in Selected Economies (2009-2012 and forecast 2013-2014)						
	2009	2010	2011	2012	2013	2014
<b>World</b>	<b>-0.6</b>	<b>5.2</b>	<b>4.0</b>	<b>3.2</b>	<b>3.3</b>	<b>4.0</b>
<b>Advanced Economies</b>	<b>-3.5</b>	<b>3.0</b>	<b>1.6</b>	<b>1.2</b>	<b>1.2</b>	<b>2.2</b>
Canada	-2.8	3.2	2.6	1.8	1.5	2.4
United States	-3.1	2.4	1.8	2.2	1.9	3.0
United Kingdom	-4.0	1.8	0.9	0.2	0.7	1.5
Japan	-5.5	4.7	-0.6	2.0	1.6	1.4
<b>Eurozone</b>	<b>-4.4</b>	<b>2.0</b>	<b>1.4</b>	<b>-0.6</b>	<b>-0.3</b>	<b>1.1</b>
<i>of which France</i>	-3.1	1.7	1.7	0.0	-0.1	0.9
<i>of which Germany</i>	-5.1	4.0	3.1	0.9	0.6	1.5
<i>of which Italy</i>	-5.5	1.7	0.4	-2.4	-1.5	0.5
<b>NIEs</b>						
Hong Kong	-2.5	6.8	4.9	1.4	3.0	4.4
South Korea	0.3	6.3	3.6	2.0	2.8	3.9
Singapore	-0.8	14.8	5.2	1.3	2.0	5.1
Taiwan	-1.8	10.8	4.1	1.3	3.0	3.9
<b>Developing Economies</b>	<b>2.7</b>	<b>7.6</b>	<b>6.4</b>	<b>5.1</b>	<b>5.3</b>	<b>5.7</b>
Developing Asia	6.9	10.0	8.1	6.6	7.1	7.3
<i>of which China</i>	9.2	10.4	9.3	7.8	8.0	8.2
<i>of which India</i>	5.0	11.2	7.7	4.0	5.7	6.2
<i>of which ASEAN-5</i>	1.7	7.0	4.5	6.1	5.9	5.5
<b>CIS</b>	<b>-6.4</b>	<b>4.9</b>	<b>4.8</b>	<b>3.4</b>	<b>3.4</b>	<b>4.0</b>
<i>of which Russia</i>	-7.8	4.5	4.3	3.4	3.4	3.8
<b>Emerging Europe</b>	<b>-3.6</b>	<b>4.6</b>	<b>5.2</b>	<b>1.6</b>	<b>2.2</b>	<b>2.8</b>
<b>Latin America and Caribbean</b>	<b>-1.5</b>	<b>6.1</b>	<b>4.6</b>	<b>3.0</b>	<b>3.4</b>	<b>3.9</b>
<i>of which Brazil</i>	-0.3	7.5	2.7	0.9	3.0	4.0
<i>of which Mexico</i>	-6.0	5.3	3.9	3.9	3.4	3.4
<b>Middle East and North Africa</b>	<b>3.0</b>	<b>5.5</b>	<b>4.0</b>	<b>4.8</b>	<b>3.1</b>	<b>3.7</b>
<b>Sub-Saharan Africa</b>	<b>2.7</b>	<b>5.4</b>	<b>5.3</b>	<b>4.8</b>	<b>5.6</b>	<b>6.1</b>

Source: IMF World Economic Outlook database, April 2013



the downward trend. Canada's export-led slowdown also contributed to the overall decline in growth in the developed world.

While the eurozone countries have engaged in fiscal austerity for several years now, the effects of this process on the region's economy have not yet been felt as keenly as last year. Credit and housing markets continue to stagnate, and unemployment remains persistently high in Europe, while debates continue on the appropriate government policy during an economic downturn. The projections are also negative for the next year. In contrast, Japan has gathered the political will for a concerted expansionary monetary and fiscal policy to get its long-ailing economy moving; the first results of this policy should be seen in 2013.

Growth also slowed considerably in the developing economies, from 6.4 percent in 2011 to 5.1 percent in 2012. Monetary policy in several of these countries responded to the slowdown in early 2012, and the policy rates were lowered in the second half of the year. Credit and economic activity have both been expanding in several Asian and Latin American countries. Capital inflows to developing economies have resumed and brought with them decreased risk spreads on equities and government bonds. Nevertheless, investors' long-term outlook in general remains clouded with uncertainty, and investment lags behind the amounts consistent with available resources and robust recovery.

While the familiar growth leaders—China, India, Brazil—have faltered in 2012, with growth rates dropping considerably, some of the “second generation” of emerging markets, of which the ASEAN-5 are perhaps the most familiar, have accelerated. The Middle East

and North Africa also grew faster than in 2011, while Mexico maintained the same rate of growth.

In the short-term forecast, growth will remain the same in advanced countries (1.2 percent in 2013). Continued monetary stimulus and reviving consumer demand are expected to bring growth up to 2.2 percent in 2014; there is also growing awareness of the role of fiscal policy multipliers. In developing countries, 2012 should be the trough of a slowly accelerating growth, expected to reach 5.3 percent in 2013 and 5.7 percent in 2014. Inflationary pressures are expected to remain low or non-existent in the developed world, with only a few exceptions in the developing world; global imbalances have been reduced substantially through the recession, though the prospects for reducing them further are uncertain and will depend on the future developments in China and Europe.

The downside risks to the outlook have been reduced as the European situation was brought under control, and the U.S. “fiscal cliff” crisis was temporarily resolved. Additionally, key developing economies have successfully avoided hard landings. Nevertheless, risks associated with these factors still exist, as do fiscal risks in Japan and new factors of geopolitical uncertainty (e.g. North Korea). Sudden movements in commodity prices also remain a possibility. The global situation and outlook have improved in the last year, but remain more uncertain than usual. Stable and consistent growth in output and employment in the eurozone continues to be a key factor for global economic stability, and the revival in the Japanese economy would also do much to fuel a worldwide economic recovery. Another upside would include a continued revival of housing, growth and employment in the United States.

## Overview and Prospects for World Trade

### Merchandise Trade

Real world trade (i.e. measured in volumes) slowed down considerably in 2012, posting a growth of just 2.0 percent. This marked the second year of slower growth, as the 2010 record expansion of 13.9 percent was followed by a subdued 5.2 percent in 2011. While an improvement is expected in 2013, the projected growth of 3.3 percent for that year is historically also low. The primary factor for the sluggish growth in world trade is the recurring uncertainty over the future of the euro. Additionally, both developed and developing countries are struggling with their particular sets of economic issues: high unemployment and fiscal pressure for the former, slowing growth, reduced global demand and the need for reforms for the latter. As for nominal world trade (i.e. measured in U.S. dollars), declining prices of traded goods ensured that it grew even slower than real trade: trade values increased just 0.2 percent in 2012, compared to 20 percent in 2011.

Real export growth in developed economies slowed down more than in the developing and emerging markets, dropping to 1.0 percent in 2012 from 5.1 percent in 2011. Export growth has slowed down everywhere, though the European Union was particularly affected as its economic and commercial growth ground to a halt. Growth in real exports from the United States continued to be the strongest driver in the performance of the developed nations. The rest of the world—including the developing economies and the Commonwealth of Independent States (CIS)—recorded a decrease in export growth to 3.3 percent in 2012 from 5.4 percent in 2011. After Africa's

volume of exports contracted by 8.5 percent in 2011, a strong rebound took place in 2012 as the region's exports grew 6.1 percent, the fastest growth of any region. As China, Japan and especially India slowed down, with the latter reversing its 15.0-percent export growth in 2011 to post a 0.5-percent decline in 2012, the overall trade volume growth in Asia was a modest 2.8 percent. South and Central America also slowed down to just 1.4-percent export growth in 2012.

Real import growth was also led by Africa, which posted a double-digit expansion of 11.3 percent. Imports to the Middle East (up 7.9 percent) and the CIS (up 6.8 percent) also expanded considerably. Asia's imports expanded by 3.7 percent, with expansion driven mainly by China's 3.6-percent real import growth. Imports into the United States also expanded, up 2.8 percent, while imports grew even faster in the rest of North America, at the rate of 3.1 percent for the whole region. South and Central America posted a real import growth figure of 1.8 percent, restrained by slow export growth, while imports into Europe actually declined by 1.9 percent as the economic crisis depressed demand.

Nominal trade slowed down even more sharply than real trade, as resource prices stagnated or weakened through the year. The overall value of global merchandise exports was US\$18.3 trillion on the Balance of Payments (BOP) basis, and US\$17.9 trillion on the customs basis, effectively unchanged from the previous year (see Table 1-2). This contrasts strongly with rates of growth in excess of 20 percent in 2010 and 2011. China continued its strong export performance, leading the world with 8-percent growth; Mexico was a strong performer as well with a 6-percent expansion. Africa led all the regions again in nominal export growth,

recording an increase of 5 percent; this number was matched by the United States. However, lower rates of export growth among all North American economies reduced export growth from this region to 4 percent. Nominal declines in exports from Japan, India and the Asian NIEs meant that the value of Asian exports was up only 2 percent in 2012, equal to the growth of the exports from the CIS. Export growth averaged 3 percent in the Middle

East, while nominal exports of South and Central America remained unchanged. Europe closed out the regional rankings, registering a 4-percent decline in export values.

Once again, Africa was ahead of all other regions in nominal import growth, posting an expansion of 8 percent in 2012. The Middle East and the CIS followed with sizeable expansions of their own, at 6 percent and

TABLE 1-2								
World Merchandise Trade by Region and Selected Countries								
(US\$ billions and %)								
	EXPORTS				IMPORTS			
	Value	2012	Annual % change		Value	2012	Annual % change	
	US\$B	Share			US\$B	Share		
	2012	(%)	2011	2012	2012	(%)	2011	2012
<b>World</b>	<b>17,850</b>	<b>100.0</b>	<b>20</b>	<b>0</b>	<b>18,155</b>	<b>100.0</b>	<b>19</b>	<b>0</b>
<b>North America</b>	<b>2,373</b>	<b>13.3</b>	<b>16</b>	<b>4</b>	<b>3,192</b>	<b>17.6</b>	<b>15</b>	<b>3</b>
United States	1,547	8.7	16	5	2,335	12.9	15	3
Canada	455	2.5	17	1	475	2.6	15	2
Mexico	371	2.1	17	6	380	2.1	16	5
<b>South &amp; Central America</b>	<b>749</b>	<b>4.2</b>	<b>27</b>	<b>0</b>	<b>753</b>	<b>4.1</b>	<b>25</b>	<b>3</b>
Brazil	243	1.4	27	-5	233	1.3	24	-2
<b>Europe</b>	<b>6,373</b>	<b>35.7</b>	<b>18</b>	<b>-4</b>	<b>6,519</b>	<b>35.9</b>	<b>17</b>	<b>-6</b>
EU-27	5,792	32.4	18	-5	5,927	32.6	17	-6
Germany	1,407	7.9	17	-5	1,167	6.4	19	-7
France	569	3.2	14	-5	674	3.7	18	-6
Italy	500	2.8	17	-4	680	3.7	14	1
United Kingdom	468	2.6	21	-7	486	2.7	15	-13
<b>CIS</b>	<b>804</b>	<b>4.5</b>	<b>34</b>	<b>2</b>	<b>568</b>	<b>3.1</b>	<b>30</b>	<b>5</b>
Russia	529	3.0	30	1	335	1.8	30	4
<b>Africa</b>	<b>626</b>	<b>3.5</b>	<b>17</b>	<b>5</b>	<b>604</b>	<b>3.3</b>	<b>18</b>	<b>8</b>
<b>Middle East</b>	<b>1,287</b>	<b>7.2</b>	<b>37</b>	<b>3</b>	<b>721</b>	<b>4.0</b>	<b>17</b>	<b>6</b>
<b>Asia</b>	<b>5,640</b>	<b>31.6</b>	<b>18</b>	<b>2</b>	<b>5,795</b>	<b>31.9</b>	<b>23</b>	<b>4</b>
China	2,049	11.5	20	8	1,818	10.0	25	4
Japan	799	4.5	7	-3	886	4.9	23	4
India	293	1.6	34	-3	489	2.7	33	5
NIEs	1,280	7.2	16	-1	1,310	7.2	19	0

Source: WTO Secretariat

5 percent, respectively. Growth of imports into Asia was only a little slower at 4 percent, as China, India and Japan maintained a similar pace for imports, with only the NIEs recording no import growth. The value of North American imports expanded by 3 percent (the United States posting an identical rate), as did the value of the imports into South and Central America, despite Brazil's 2-percent contraction in imports. Nominal imports into Europe fell

substantially, losing 6 percent of their value; the United Kingdom was the runaway leader in this process, shedding 13 percent in imports.

### Trade in Services

The value of global exports of services increased by just 2 percent in 2012 to reach US\$4,345 billion, after two years of annual expansion of about 10-percent (see Table 1-3). Since 2005, services trade grew by 8 percent

	EXPORTS				IMPORTS			
	Value	2012	Annual % change		Value	2012	Annual % change	
	US\$B	Share			US\$B	Share		
	2012	(%)	2011	2012	2012	(%)	2011	2012
<b>World</b>	<b>4,345</b>	<b>100.0</b>	<b>11</b>	<b>2</b>	<b>4,105</b>	<b>100.0</b>	<b>11</b>	<b>2</b>
<b>North America</b>	709	16.3	9	4	537	13.1	8	2
United States	614	14.1	9	4	406	9.9	7	3
Canada	78	1.8	10	-1	105	2.6	10	1
Mexico	16	0.4	0	5	25	0.6	16	0
<b>South &amp; Central America</b>	136	3.1	13	6	178	4.3	18	9
Brazil	38	0.9	20	5	78	1.9	22	7
<b>Europe</b>	2,024	46.6	12	-3	1,680	40.9	10	-3
EU-27	1,819	41.9	12	-3	1,553	37.8	10	-4
Germany	255	5.9	9	-2	285	6.9	11	-3
France	208	4.8	17	-7	171	4.2	12	-10
Italy	104	2.4	9	-1	105	2.6	5	-8
United Kingdom	278	6.4	10	-4	176	4.3	6	1
<b>CIS</b>	105	2.4	19	10	151	3.7	18	17
Russia	58	1.3	20	10	102	2.5	23	16
<b>Africa</b>	90	2.1	0	5	162	3.9	12	3
<b>Middle East</b>	125	2.9	10	9	222	5.4	11	2
<b>Asia</b>	1,159	26.7	12	6	1,175	28.6	14	8
China	190	4.4	13	4	281	6.8	23	19
Japan	140	3.2	3	-2	174	4.2	6	5
India	148	3.4	11	8	125	3.0	6	1
NIEs	417	9.6	12	8	321	7.8	10	4

Source: WTO Secretariat and author's calculations

per year on average, the same rate as that of merchandise trade.

According to the WTO, the share of services in total trade (goods and services) on the BOP basis rose to about 19 percent in 2012. It should be noted that this figure only measures the gross final flows of services trade and does not account for the various intermediate services used as inputs along the way. Indeed, evidence recently assembled in a joint project by the OECD and the WTO (see the *Trade in Value-Added* box) indicates that this figure considerably underestimates the contribution of services to the final total of world trade.

For the second year running, the CIS region was the fastest-growing exporter of services in 2012, posting a 10-percent expansion. Exports from the CIS countries reached US\$105 billion, with Russia, whose exports also grew by 10 percent, accounting for over half of this total. The Middle East was not far behind with 9-percent growth—the only region whose exports showed almost no decline since 2011. Asia and South and Central America each posted growth of 6 percent, despite Japan's contraction of 2 percent, which was offset by India and the NIEs. Africa shook off the stagnation of 2011 and increased its exports of services by 5 percent, and North America saw 4-percent

growth, even as Canada's exports contracted by 1 percent. Nevertheless, global growth was brought below those figures as Europe, the provider of nearly half of the world's services (over \$2 trillion' worth), posted a decline of 3 percent; France, Switzerland and the Netherlands were the heavy losers, each down 7 percent.

On the import side, the CIS was also the growth leader among the regions, increasing its imports of services by 17 percent to US\$151 billion, two-thirds of which were destined for Russia. Imports of services into South and Central America expanded by 9 percent in 2012—half the 2011 rate. Asia's imports of services grew impressively at 8 percent, though not as impressively as China's, which gained 19 percent; meanwhile, imports of services into India expanded just 1 percent. Imports of services into Africa increased just 3 percent, and grew 2 percent for both the Middle East and North America. Europe, once again, showed a loss of 3 percent of its imports of services, with France losing 10 percent and Italy losing 8 percent.

Europe and North America continued to be net exporters of services, with import shares of 40.9 percent and 13.1 percent, as opposed to export shares of 46.6 percent and 16.3 percent, respectively.

**TABLE 1-4**  
World Exports of Services, 2005-2012  
(US\$ billions and %)

	2012 Exports (US\$B)	Share (%)	2012 growth (%)	2011 growth (%)	2005-2012 growth (%)
<b>All Services</b>	<b>4,345</b>	<b>100.0</b>	<b>2</b>	<b>11</b>	<b>8</b>
Transportation	885	20.4	2	9	7
Travel	1,105	25.4	4	12	7
Commercial services	2,350	54.1	1	12	10

Source: WTO secretariat

By service category, travel services were the fastest-growing services sub-category in 2012, up 4 percent. Transportation services grew sluggishly in tandem with world commerce as a whole, gaining only 2 percent. Commercial services were the slowest-growing category with 1-percent growth—contrasting with its 10-percent average growth between 2005 and 2012. Several components of commercial services declined in 2012. The biggest decline was observed in financial services, which were down 4 percent. In particular, a 4-percent decline in financial services exports took place in the United States, a 13-percent drop occurred in the United Kingdom, and several European countries recorded severe losses as well, in particular Greece (down 29 percent), Cyprus (down 21 percent), Spain (down 11 percent) and Austria (down 11 percent). These declines were offset to some extent by gains in Japan (up 13 percent) and China (up 58 percent). In other sub-categories, computer and information services rose 6 percent in 2012, construction services rose 3 percent and communications services dropped 3 percent.

### Prices and Exchange Rates

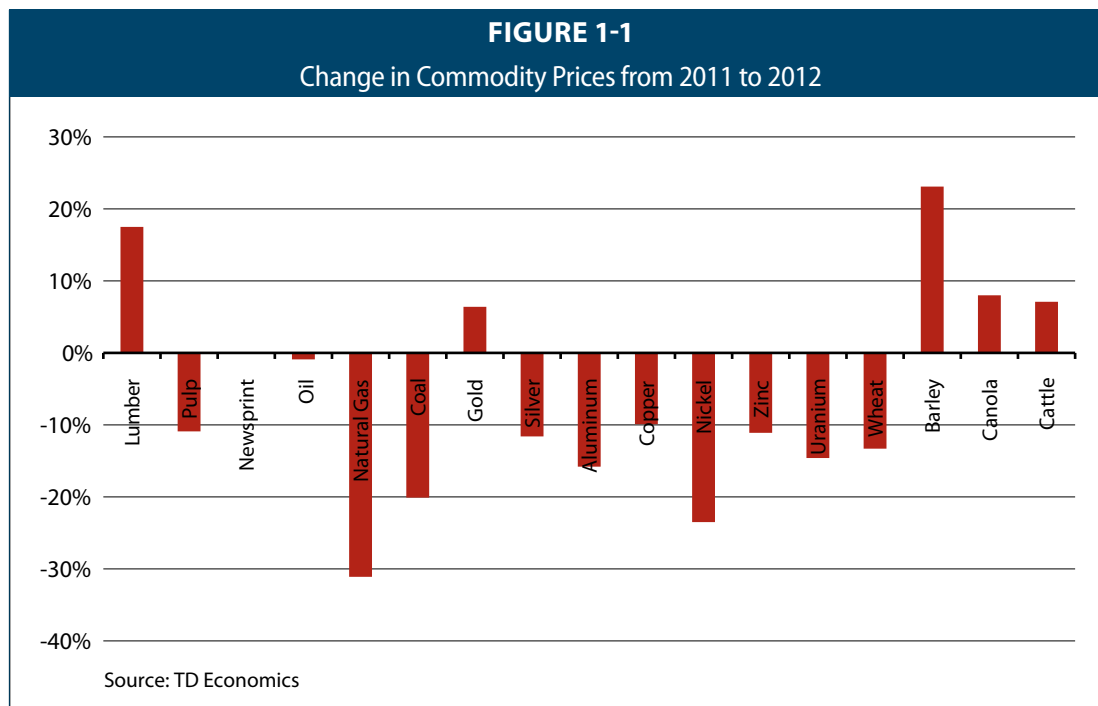
Two years of large increases in commodity prices were followed by a weakening in 2012. According to the IMF, the broad commodity price index declined by 3 percent last year, after rising by 26 percent in 2010 and by 29 percent in 2011. Beverages, including coffee, tea, and cocoa, were the most affected category, losing 19 percent of value; metal prices fell 17 percent; and prices of agricultural raw materials fell 13 percent. Broad food and energy prices moved less—a 2-percent decline for food and a 1-percent uptick for energy prices.

For Canada, patterns differed from the world's somewhat, overall, as well as, for the individual commodities (Figure 1-1). Lumber prices jumped up 18 percent, while pulp prices declined 11 percent. No price increase was observed in any component of the energy sector: although oil declined by just 1 percent, the price of natural gas dropped 31 percent and the price of coal was down 20 percent. The price of gold increased by 6 percent, but silver prices fell 12 percent during the year. Most metal prices fell; the range of price declines was between 10 percent for copper and 24 percent for nickel. Prices in the agricultural sector mostly expanded, with barley leading at 23 percent and canola up 8 percent, but wheat was down 13 percent, undercutting Canada's surplus in this commodity.<sup>1</sup>

According to the Bank of Canada's sectoral price indices, which are based on Canadian production and world market sales, Canadian energy products continued to experience price disadvantages, with their price index dropping 9 percent during 2012. Metals and minerals prices lost 4 percent, but forestry prices increased 5 percent. Agricultural prices, which rose by almost one third in 2011, gained only 2 percent in 2012.<sup>2</sup> Weighting commodity prices according to Canadian production, the index moved down 6 percent last year, but stayed constant if energy prices were excluded. Energy prices dragged down the overall commodity price growth; lower relative prices for Canadian-produced oil were discussed at length in the last year's *State of Trade* report (see Chapter 4 box on WTI and Brent pricing).

1 *Commodity Price Report*, TD Economics, 2013.

2 Bank of Canada Commodity Price Index: <http://www.bankofcanada.ca/rates/price-indexes/bcpi/>



West Texas Intermediate (WTI) crude oil prices opened the year at US\$102.96 a barrel. In late February, prices rose to US\$109.39 a barrel and stayed above US\$100 a barrel until May. A protracted decline took the price down to US\$77.72 by the end of June. An increase started in July and oil price reached US\$98.94 by mid-September. However, another weakening took it below US\$90 at the end of October, and it only came back above that value in the last week of the year, with the last reading of US\$91.83 on December 31, 2012. The average WTI price for 2012 declined 1 percent compared to the 2011 average, according to the U.S. Energy Information Administration.<sup>3</sup>

Gold prices averaged US\$1,669.03 per troy ounce in 2012, up 6 percent from US\$1,571.97 in 2011. Prices reached US\$1,781 in February

2012 before declining mid-year, and then staged another rally in the fall before declining to the year-end value of US\$1,655.50 per troy ounce.<sup>4</sup>

According to the Federal Reserve Bank of St. Louis, the US dollar appreciated against most major currencies between 2012 and 2013, rising almost 4 percent on average (although the Chinese yuan appreciated 2.4 percent against the dollar, and the Japanese yen remained unchanged). This would tend to understate the value of some trade flows in 2013 and overstate the magnitude of any declines from 2012.

According to the Bank of Canada's average monthly exchange rate statistics, the Canadian dollar started the year just below parity with the U.S. dollar (US\$0.987 in January), reached

<sup>3</sup> Price behaviour of WTI oil is based on trade in the spot market at Cushing, Oklahoma, as quoted by the U.S. Energy Information Administration (EIA) at <http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=pet&s=rwtc&f=w>.

<sup>4</sup> Prices per troy ounce, London Afternoon (PM) Gold Price Fixings as quoted in <http://www.usagold.com/reference/prices/2011.html>.



parity and stayed there through late winter and early spring before falling to US\$0.973 in June 2012. From there, its value increased to US\$1.022 in September, but subsequently slid back to parity and ended the year at the US\$1.011 monthly average for December.<sup>5</sup>

### Prospects

The world trade outlook for 2013 and 2014 contains some uncertainties, associated primarily with the health of the European economy. The economic downturn in Europe has now spread to previously unaffected Germany. Its economy is expected to prove more resilient to the recession than most, but much weakness is still expected in Europe for the first half of 2013, with improvements later in the year. In the United States, private expenditure continues to grow, and unemployment is slowly reduced, but the automatic spending cuts (sequestration) are expected to shave 0.4 percent off GDP growth there in 2013. The Federal Reserve has taken new steps to promote recovery, and its accommodative monetary stance is expected to continue into the future. Good news is also expected from Japan, whose oversized package of accommodative monetary policy and a large

fiscal stimulus may spur economic growth in the country. Questions remain about how effective it would be, with concerns about a public debt that now exceeds 200 percent of GDP. China's exports to the United States recently exceeded its exports to the EU whose economy was faltering; China's growth continues to be relatively strong, leaving room for increased imports from other countries as its consumer market expands.

These developments suggest some acceleration in the growth of the volume of world trade can be expected, from 2.0 percent in 2012 to 3.3 percent in 2013. Exports from the developed economies will increase by 1.4 percent, while those from the developing world will gain 5.3 percent. While figures for 2014 are considerably more uncertain, world trade growth is expected to improve to 5.0 percent in that year, with exports of developed and developing nations increasing by 2.6 percent and 7.5 percent, respectively. The forecast remains subject to revision should the euro crisis, geopolitical tensions or commodity prices become more volatile. ■

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<sup>5</sup> Bank of Canada exchange rate statistics: <http://www.bankofcanada.ca/rates/exchange/monthly-average-lookup/>.



# Economic and Trade Developments: Regional and Country Review

Challenges and uncertainty were the overall hallmarks for the global economy and economic outlook in 2012, but with the focus shifted to the level of individual countries and regions a more varied picture emerges of multiple issues, prospects and opportunities for economic growth in the world's most important economies and regions. These go hand in hand with prospects and opportunities for Canadian commercial activities. This chapter provides an overview of the most relevant economic and trade developments in those countries and regions offering the most prospects for Canada.

## Country Overview

### United States

#### *Economic Overview*

In recent years, economic growth in the United States has undergone many upturns and setbacks. In early 2010, strong expansion, based partly on post-recession inventory restocking, encouraged hopes for a speedy recovery—and even stoked inflationary fears. The hoped-for recovery did not occur; growth in the United States almost halted in the first quarter of 2011 and then gathered speed for the rest of that year to end at 1.8-percent growth for the year—down considerably from 2.4-percent growth in 2010. The combined effects of high unemployment, an unresolved mortgage situation, political brinkmanship and reduced government spending at all levels continued to hold back demand despite an active monetary policy.

The pace of the increase in activity at the end of 2011 proved unsustainable, driven as it was mostly by inventory investment. In the first quarter of 2012, growth was halved to 2.0 percent as inventory investment and non-residential fixed investment decelerated. In the second quarter, growth weakened further to 1.3 percent, as personal consumption expenditure (PCE), non-residential fixed investment and residential fixed investment all decelerated. The highest growth was observed in the third quarter, with the 3.1-percent expansion driven by increased inventory investment, higher government spending at all levels and a downturn in imports. Cuts in defence spending and inventories, as well as disruptions caused by Hurricane Sandy, reduced fourth-quarter growth to a mere 0.4 percent.

Real GDP increased 2.2 percent in 2012 (that is, from the 2011 annual level to the 2012 annual level), which was up from the 1.8-percent increase in 2011. The increase in real GDP in 2012 primarily reflected positive contributions from PCE, non-residential fixed investment, exports, residential fixed investment, and private inventory investment that were partly offset by negative contributions from federal government spending and state and local government spending. Imports, which are a subtraction in the calculation of GDP, increased.

The acceleration in real GDP in 2012 primarily reflected a deceleration in imports, upturns in residential fixed investment and in private

inventory investment, and smaller decreases in state and local government spending and in federal government spending that were partly offset by decelerations in PCE and in exports. The price index for gross domestic purchases increased 1.7 percent in 2012, down from the 2.1-percent increase in 2011. Current-dollar GDP increased 4.0 percent, or \$609.1 billion, in 2012, compared with an increase of 4.0 percent, or \$576.8 billion, in 2011.

PCE slowed down from the 2.5-percent pace of 2011, increasing 1.9 percent in 2012 and adding 1.32 percentage points to real GDP growth. This represented a sizeable decrease over 2011, when it contributed 1.79 percentage points. In 2012, the biggest increase in consumer spending was in durable goods, which grew 7.8 percent and added 0.58 percentage point to real GDP growth. Spending on services grew just 1.2 percent, contributing 0.58 percentage point to real GDP. Consumer spending on non-durables decelerated even further, to 0.9 percent, which added only 0.15 percentage point to real GDP growth.

Growth was booming for most investment components in 2012, most of all for residential investment. Growth in this area reached 12.1 percent on the year, a remarkable rebound after the negative growth in the preceding years that added 0.27 percentage point to GDP growth. Housing starts rose 28 percent in 2012, albeit from a modest baseline of 609,000 units. Non-residential fixed investment also picked up in 2012, growing 8.0 percent and adding 0.78 percentage point to GDP growth. Investment in structures continued to pick up, but investment in equipment and software slowed to 6.9 percent in 2012, down from 11.0 percent in 2011.

Inventory investment in 2012 was no longer a drag on real GDP, as it had been in 2011, yet contributed only 0.14 percentage point to growth—all in non-farm inventories, as farm inventories continued to decline. Net exports added only 0.04 percentage point to GDP growth in 2012, as growth in both imports and exports declined sharply.

Spending at all levels of government fell for the second consecutive year, down 1.7 percent in real terms. The continued decline affected mostly defence spending at the federal level; the decline in state and local government spending moderated somewhat. The drag on GDP growth from reduced government spending halved from 0.67 percentage point in 2011 to 0.34 percentage point in 2012.

The labour market situation in the United States improved considerably during 2012, with particularly strong employment growth in the fourth quarter when the economy added 201,000 jobs per month on average. Overall, however, the rate of job creation is still too slow to reduce the pool of unemployed created by the recession within the next year or two. The unemployment rate started the year at 8.5 percent, declined to 8.1 percent by April, where it remained until September, when it lurched downward to 7.8 percent just before the presidential election. The rate stayed at that level until the end of the year; employment growth in early 2013 was lukewarm, yet by April 2013 the unemployment rate had gone down further to 7.5 percent. The participation rate remained stable, just below 64 percent, about 2 percentage points below the long-run trend, reminding of the number of the discouraged workers who have given up looking for work. From the peak of employment in January 2008 until December 2009, 8.7 million jobs were lost in the United

States; by the end of 2012, 5.3 million jobs had been recouped. The post-recession challenge is not complete by any means, as a large proportion of this increase in employment will be covered by population growth, but at least the sizeable and consistent employment growth, not seen in the previous recovery years, is back.

Despite the fourth-quarter slowdown in the U.S. (which preliminary reports considered a contraction), prospects for the U.S. economy for 2013 are encouraging. Manufacturing confidence continues to improve, with capital goods orders rebounding in the fourth quarter of 2012; the vehicle sales and housing markets are also in the ascendant. Housing starts are expected by IHS Global Insight to increase 24 percent in 2013, to 970,000 units, and then gain another 30 percent in 2014. The continued strength in natural gas and oil drilling activity, and the associated orders for capital goods and structures, may provide an additional boost to the economy. On the negative side, consumer confidence has weakened, possibly because the payroll tax cut has ended. Fiscal issues will continue to affect the economy; IHS Global Insight projects the current sequester, expected to last at least until September, will shave 0.4 percent off GDP growth. The combination of slower growth around the world and some appreciation in the U.S. dollar is expected to moderate the demand for U.S. exports and hence restrain their growth. Inflation will remain a non-issue for the foreseeable future, and monetary policy will continue to be highly accommodating into 2014. The IMF's expectations for 2013 are for 1.9-percent growth in the United States, accelerating to 3.0 percent in 2014.

Downside risks to this scenario remain centred on the internal political difficulties and partisan gridlock in the U.S. congress. The scheduled automated spending cuts already contribute

negatively to economic growth, and another debt ceiling impasse could have more serious effects. But the European sovereign debt crisis remains the main foreign influence, and could potentially dampen business confidence and investment in the United States. Possible weakness in China and other emerging economies poses another risk factor. On the upside, stronger-than-expected recovery in the housing sector is a possibility.

### *Bilateral Trade Overview*

Trade with the United States has long been a cornerstone of the Canadian economy. While Canada has made considerable efforts lately to reach new markets and diversify Canadian commercial activities in order to take advantage of opportunities arising across the globe, Canada has always acknowledged the paramount role of its closest neighbour to the south. In 2012, this role was reconfirmed as the United States simultaneously increased its share of both exports to and imports from Canada for the first time in decades. As Canada's top supplier of merchandise imports, the United States is now responsible for over half of all imports into Canada; the U.S. share is even greater as an export destination, accounting for nearly three quarters of Canada's merchandise exports. As the U.S. recovery slowly gathers speed, the U.S. share of Canada's trade has improved because Canada's trade with the United States is growing faster than Canada's trade with the rest of the world. Indeed, the United States led the growth among the large advanced economies in 2012, showing that the strength of its economy is on the mend and that the United States cannot be counted out. Canada's close commercial engagement with the United States continues with the implementation of joint action plans and now through the Trans-Pacific Partnership negotiations as well.

U.S. trade expansion slowed in 2012, in concert with world trade in general, and growth in exports (5.5 percent) exceeded growth in imports (4.1 percent). As imports (US\$2.3 trillion) greatly exceeded exports (US\$1.5 trillion), the US\$0.7-trillion trade deficit remained practically unchanged. Canada remains the most important trading partner of the United States, ahead of China and Mexico in total trade (16.1 percent of the total), as well as the number one destination for exports from the United States (18.9 percent of the total) and the second-largest source of imports for the United States (14.3 percent of the total).

With respect to Canada's bilateral trade with the United States, mineral fuels and oil (primarily crude) remain the top export category, accounting for \$105.8 billion out of \$338.7 billion total merchandise exports, or 31.2 percent. Automotive products, the second-largest export category at \$58.4 billion, experienced the largest growth in 2012 (up \$8.1 billion). Mechanical machinery ranked a distant third, with exports of \$23.1 billion. Other important export categories include plastics, electric machinery, paper and paperboard, aluminum, and precious stones and metals. Exports in the latter three categories declined substantially in 2012, primarily due to lower prices. By contrast, exports of wood and articles of wood, aircraft and parts, and articles of iron and steel grew substantially. In addition, various agricultural and food industries did well to increase their exports last year: exports of cereals (mainly wheat) grew by 28.9 percent, of live animals by 16.1 percent, and of animal feed by 39.0 percent.

Automotive products were Canada's leading import from the United States, accounting for almost one fifth of the total, at \$45.7 billion. Mechanical machinery imports ranked second,

at \$35.5 billion; imports in both categories grew strongly over 2012 (8.7 percent and 9.6 percent, respectively). Imports of mineral fuels and oil ranked third, at \$17.4 billion, and electrical machinery ranked a close fourth, at \$14.8 billion. Plastics imports closed out the top five, at \$11.6 billion. Other key import categories included precision instruments, articles of iron and steel, iron and steel, paper, pharmaceutical products and rubber and articles of rubber.

## China

### *Economic Overview*

Despite fears of abrupt deceleration and a hard landing in China that dominated discussions of emerging markets in 2012, the Chinese economy performed rather well. Although growth declined from 10.5 percent in 2010, to 9.3 percent in 2011, then to 7.8 percent in 2012, most of the feared outcomes failed to materialize. Industrial output and investment remained high and stable, although exports showed considerable volatility due to declining foreign demand. While fiscal and monetary support policies produced a beneficial effect on output, property markets continued to heat up, particularly along the coast, and policies put in place to restrain growing housing prices and promote affordability slowed growth.

Weakness in foreign demand was among the major causes of the slowdown in growth in 2012. In particular, the European fiscal and economic crisis led to a decrease in exports from China to that region (down 5.1 percent). As a result, China's overall exports grew only 9.0 percent in 2012; import growth was even slower, at 5.4 percent, with lower import prices largely responsible for the slowdown. China's trade surplus increased for the first time since 2008, reaching \$233 billion—although that figure is below 3 percent of GDP and less than

half the pre-crisis level, testifying to the partial correction of the global imbalances. As the terms of trade improved substantially, with the prices of imported raw materials falling, China realized a gain equivalent, by some estimates, of about 0.8 percentage point of GDP.

The Chinese government has been mostly successful in limiting the rise in housing prices, but the urbanization process continues, pushing the urbanization rate to 52.6 percent in 2012. Real estate investment slowed down, but overall investment boomed, growing 22 percent during the year (real terms), led by infrastructure investment. Inflation remained under control, with 2.7-percent growth in 2012, well below the government target limit of 4.0 percent.

The outlook for 2013 is for 7.8-percent growth, modest by China's standards. Housing market and net exports are expected to be less of a drag on growth this year; however, fiscal policy, which added in the vicinity of 0.5 percentage point to GDP growth in 2012, is likely to be less supportive in 2013. Monetary policy should remain accommodative, with little prospects of inflation; further improvement in the terms of trade, if any, is likely to be small. IHS Global Insight projects private consumption will grow substantially in the short-term and trade growth will speed up, bringing GDP growth to 8.5 percent by 2015.

### ***Bilateral Trade Overview***

China's total trade continued to expand, reaching \$3.9 trillion in 2012 and just passing the United States for the first time since records were kept. China continued as the world's top merchandise exporter, with \$2.0 trillion in exports, and second-largest importer, with \$1.8 trillion in imports. Its export share constituted 11.5 percent of global exports, and

its import share amounted to 10.0 percent of global imports.

Canada's bilateral trade with China continued to increase in 2012, up 7.8 percent to reach \$70.1 billion. As in 2011, growth in Canada's exports to China (up 15.1 percent) outpaced the growth of Canada's imports from China (up 5.3 percent), although the sheer volume of imports ensured that the increases in dollar terms were practically equivalent. Nevertheless, while Canadian exports to many destinations flatlined, Canadian exporters have managed to increase business with China—a substantial achievement. For two consecutive years, Canada's trade deficit with China has remained stable. In 2012, China became Canada's second-largest export market, with exports valued at \$19.4 billion. Imports grew to the \$50.7-billion mark, producing a trade deficit of \$31.4 billion. From 2006 to 2012, Canada's exports to China grew 16 percent per year on average, while Canada's global exports during the same period only grew 0.5 percent per year on average.

Canada's top export category to China was ores, slag and ash, at \$2.7 billion, primarily composed of iron ore, but with a considerable contribution from copper ore. China, Canada's top market for ores, imported 31.4 percent of Canada's global ore exports. Wood pulp and recycled paper ranked a close second, with \$2.6 billion in exports, largely unchanged from the previous year. Meanwhile, a large increase in oilseed exports (mainly canola seeds) made China the top destination for this category, and made oilseeds Canada's third-largest export commodity to China: exports increased by \$1.5 billion to reach \$2.5 billion in 2012. Mineral fuels and oil, another important export category, ranked fourth, with \$2.1 billion in



exports, a 59-percent increase. While most of that increase was in coal, the main export product, it is notable that crude oil exports grew as well, as China is the only country, apart from the United States and the United Kingdom (in 2012), to which Canada exports crude oil. Canada's wood exports to China suffered as housing construction slowed abruptly, but with that in mind they did not do too badly, losing just 3.9 percent in value to end at \$1.4 billion. The robust demand by Chinese consumers for edible oils made China an important market for Canada's canola oil, exports of which nearly doubled in 2012 to reach \$1.2 billion.

The top ten items on the list of Canadian imports from China have changed considerably in recent years. Although China once had a reputation as a producer of cheap consumer goods, toys and clothing, China's production of these goods is declining and is now increasingly taking place in other Asian countries while Chinese industry moves up the value chain. In 2012, Canada's imports of toys, goods and sporting equipment from China declined again, to \$2.6 billion, down 4.9 percent; imports of knitted and crocheted apparel articles declined to \$2.0 billion, down 7.2 percent; and imports of other apparel articles declined to \$2.0 billion, down 8.1 percent. Meanwhile, higher value-added, technology-intensive products rose to the top of the list. Imports of the top article, electrical machinery (primarily cell phones and wireless network devices) grew 8.4 percent to \$12.8 billion; and imports of mechanical machinery (primarily computers), ranked second, grew 7.9 percent to \$10.2 billion. Canadian consumers are also showing more interest in China-made automotive products: automotive imports posted 19.8-percent growth in 2012, to reach \$1.5 billion. Motor vehicle parts and accessories comprised two

thirds of this category, but vehicle imports increased six-fold from 2011 to \$133 million in value (and 22,000 in quantity).

## Germany

### *Economic Overview*

The deepening European slowdown has manifested itself in another Europe-wide recession, and this time Germany was not immune. Weakness has spread from the periphery to the core, resulting in a weak 0.9-percent real GDP growth in 2012 and a downward revision of the short-term outlook. Economic growth slowed considerably in the second half of the year, although an outright recession seems to have been avoided so far.

On the use side of the gross domestic product, foreign trade proved to be very robust, considering the difficult external environment. In 2012, Germany's exports of goods and services in price-adjusted terms were up a total of 4.1 percent over 2011. At the same time, imports rose by just 2.3 percent. However, in nominal terms, merchandise exports decreased by 3.4 percent and merchandise imports contracted by 5.9 percent. The balance of exports and imports contributed 1.1 percentage points to GDP growth in 2012 and, consequently, was once again the main driving force for economic growth in Germany.

Domestic demand developed in divergent directions. Household final consumption expenditure increased (up 2.4 percent) as did government final consumption expenditure (up 2.7 percent), whereas gross fixed capital formation fell by 0.8 percent. As a result, capital formation failed to make a positive contribution to GDP growth for the first time since the economic crisis of 2008-09, dragging GDP growth down by 0.4 percentage point. Gross

fixed capital formation in construction fell by 1.1 percent, and gross fixed capital formation in machinery and equipment by as much as 4.4 percent. Household final consumption expenditure and government final consumption expenditure boosted GDP growth by 0.4 percentage point and 0.2 percentage point, respectively. A characteristic feature of the GDP in 2012 was that in the service branches, price-adjusted gross value-added rose; however, gross output decreased in both industry (down 0.8 percent) and construction (down 1.7 percent).

The number of employed people reached a record level for the sixth consecutive year in 2012 (41.6 million). Labour productivity (price-adjusted gross domestic product per person in employment) was down 0.3 percent in 2012. When measured per hour worked, however, labour productivity increased by 0.4 percent because the increase in the number of total hours worked was smaller than the increase in the gross domestic product.

Governments continued to consolidate their budgets in 2012. According to provisional calculations, general government—comprising the central, state and local governments as well as social security funds—recorded net lending of 2.2 billion euros at the end of the year. Compared with the previous year, the central government again reduced its deficit considerably, whereas local governments and especially the social security funds achieved a large surplus, as in 2011. For the first time since 2007, general government showed a balanced budget for 2012.

Prospects for 2013 are for slow 0.6-percent growth, as the European weakness marking the first half of the year continues. Weak export growth can therefore be expected since Europe

remains Germany's dominant marketplace, accounting for 57 percent of its exports. Since exports represent the principal engine of the German economy, reduced exports will restrain growth, unless producers can find new markets among faster-growing emerging economies. Growth is expected to pick up somewhat, achieving 1.5 percent during the year 2014 - a rather modest target. Downside risks include further aggravation of the European crisis in the fiscal, economic or political areas; upside hopes are linked to the well-known resiliency and power of the German economy, which may adjust and find its way out of the European doldrums in as-yet unpredictable ways, perhaps even leading the rest of Europe out.

#### *Bilateral Trade Overview*

Germany's foreign trade is characterized by its reliance on high-value-added exports in specialized areas where brands with worldwide recognition ensure steady demand. German automotive, machinery and pharmaceutical products bear the hallmark of quality and constitute the core of Canada's imports from Germany. While revised figures for German trade indicate that trade contracted in nominal terms in 2012, much of the contraction was due to the effects of prices and weakened demand from Germany's European neighbours. Germany's exporters reacted quickly by shifting their attention to the United States and China; shipments to these destinations increased considerably in 2012, although not enough to offset weakness closer to home.

Likewise, exports from Germany to Canada registered a notable increase in 2012, gaining \$1.5 billion to reach the \$14.3-billion mark (up 11.7 percent)—driving total trade to \$17.9 billion, which eclipsed the pre-crisis record of \$17.2 billion. Canadian exports to Germany, however, did not follow suit and decreased

9.5 percent due to weaker demand, losing \$0.4 billion to end at \$3.6 billion. 2012 was a good year for Canada's principal export article to Germany, machinery, with export values holding their own at \$0.7 billion; ore exports performed likewise, at \$0.5 billion. However, exports of aircraft and parts decreased considerably, from \$0.5 billion in 2011 to \$0.3 billion in 2012, although this is a large-contract industry characterized by cyclical sales of airplanes. Canada's coal exports to Germany lost almost half of their value, falling to \$0.1 billion.

The surge in imports from Germany was led by the top two categories, automotive products and machinery. Shipments of automotive products increased 14.7 percent, adding \$0.5 billion to end up at \$4.2 billion. Imports of machinery grew even faster, up 24.2 percent, adding \$0.6 billion to end up at \$3.3 billion. Pharmaceutical products registered a small increase of 6.3 percent, while electrical machinery imports grew faster, at 19.3 percent, to reach \$1.3 billion. Precision instruments closed out the top five import categories, with \$0.9 billion in imports; together, these top five categories accounted for over three quarters of the value of Germany's exports to Canada.

## Japan

### *Economic Overview*

2012 added a new chapter to Japan's unique economic story. After 4.7-percent growth in 2010, which led the major advanced nations, 2011 became the year of natural disasters that threw Japan back into a recession that saw its GDP decline by 0.6 percent. Post-disaster recovery continued in the first quarter of 2012, with 6.1-percent growth, but then the Japanese economy ran out of steam, slipping back into recession in the second quarter with a 0.9-percent contraction followed by a 3.7-percent

contraction in the third quarter. Weaker demand was cited as the main reason for this contraction, with the current territorial dispute between Japan and China over certain islands particularly affecting demand from Japan's largest trading partner. Growth returned in the fourth quarter, although weak at 0.2 percent. For 2012 as a whole, the Japanese economy posted real output growth of 2.0 percent—par for the course considering the difficult global economic situation, but below par with respect to its potential.

Prime Minister Shinzō Abe's bold fiscal and expansionary monetary policy aims to harness that potential. In January 2013, the Prime Minister and the Bank of Japan expressed their joint commitment to spend 10.3 trillion yen (C\$114.7 billion) to resuscitate economic growth. This new spending is intended mainly for disaster prevention and post-earthquake reconstruction (C\$42 billion) as well as for private investment stimulus measures (C\$34.5 billion). Altogether, the Japanese government is injecting 20.9 trillion yen (C\$232.8 billion) into the economy over 15 months, which represents 4 percent of its 2012 GDP. To put this percentage into perspective, the International Labor Organization estimates that the average fiscal stimulus among advanced economies in response to the 2008-2009 crisis was 3.4 percent of their respective GDPs. The first indications seem to point to positive results for so-called Abenomics: the Japanese economy grew by 2.4 percent in the first quarter of 2013 and is projected to continue recovering. The IMF forecasts 1.6-percent growth in 2013 and 1.4-percent growth in 2014; Japanese domestic forecasts are more optimistic. The success or failure of Abenomics may be crucial for other advanced economies as their leaders decide on the policies that will best guide their economies back onto the road to recovery.



Private consumption grew 2.3 percent in 2012 and was the key contributor to real GDP, contributing 1.4 percentage points. Government consumption grew even faster, at 2.6 percent, contributing another 0.5 percentage point to output growth. Public investment was particularly strong as reconstruction continued, growing 12.5 percent and adding 0.6 percentage point to real GDP growth. Private residential and non-residential investment grew by 3.0 percent and 2.0 percent, respectively. Private residential investment contributed 0.1 percentage point to real GDP growth, while non-residential investment contributed 0.3 percentage point to real GDP growth in 2012.

Trade continued to be a drag on Japan's GDP. The 0.1-percent contraction of exports negated the contribution of exports to output, and the drag from imports increased to 0.9 percentage point of GDP as imports expanded 5.4 percent in real terms. This combination resulted in a negative 0.9-percent point impact by net exports on GDP growth.

The unemployment rate started the year at 4.5 percent, a fairly high level for Japan, but declined in the spring to end the year at 4.3 percent—the average for 2012. Natural disasters were partly responsible for the difficult employment situation. Japan's monetary policy relaxed considerably and became accommodating, generating inflation expectations, which are part of the revitalization strategy. Although active fiscal policy continues to drive public spending to very high levels, with the outstanding debt well over 200 percent of GDP, that debt is largely domestic and held at very low rates, diminishing its present impact.

Prospects for Japan are positively influenced by its active monetary and fiscal policy, with

forecasts depending on its effectiveness. Downside risks are nevertheless quite significant. Further cooling of relations with China could deal a serious blow to Japanese exporters; the intensification of the European debt crisis would further curtail exports; and the domestic political controversy could reverse the potential benefits of economic programs that have not been in place long enough to build momentum and confidence. Japan's economic performance in 2013 may be likened to the unfolding of a vast natural experiment; depending on how well it performs, Japan's economy could offer important lessons to the rest of the global community on the management of economic crises in the future.

#### *Bilateral Trade Overview*

Japan's exports were negatively affected by the territorial dispute with China in 2012. Nominal exports fell by 3.1 percent during the year, while nominal imports grew by 3.5 percent. Japan's policy in 2013 is expected to result in a weaker yen, which in turn will stimulate Japan's exports. The Japanese government has also expressed interest in furthering its trade relations by taking part in the Trans-Pacific Partnership talks.

In 2012, Japan was Canada's fourth-largest trade partner, both as exporter and as importer. Canadian exports to Japan totalled \$10.4 billion, having declined by 3 percent during the year, mostly through reduced exports of coal. Canada's imports from Japan surged, growing 15.1 percent in 2012 to reach \$15.0 billion. Coal, canola seeds and copper ore are the principal commodities Canada exports to Japan, followed by wood, meat and wheat. Exports of canola seeds and wheat underwent double-digit growth in 2012, while exports of wood pulp, aluminum and inorganic chemicals declined.

Canada's leading imports from Japan are motor cars, motor vehicle parts and bulldozers, followed by electric machinery and precision instruments. Canada's imports of Japanese automotive products grew 25 percent in 2012; imports of articles of iron and steel grew 29 percent; imports of aircraft and parts grew 39 percent; and imports of tools and cutlery of base metals increased by 60 percent.

The recently released database on trade in value-added (TiVA) goods and services shows that Japan's role as a trading partner with Canada is far greater than gross trade figures would suggest. Using TiVA data, the substantial Japanese content in Chinese exports to Canada would boost reported Japanese exports to Canada by about 20 percent.

## United Kingdom

### *Economic Overview*

The United Kingdom endured its second recession of the decade throughout much of 2012. The 2008-09 financial crisis delivered a major hit to the large U.K. financial sector, causing output to decline 4.0 percent in 2009. A small 1.8-percent rebound in 2010 was followed by an even smaller 0.9-percent rebound in 2011. Four of the last six quarters (ending with the first quarter of 2013) have resulted in output contractions. Output growth in the first quarter of 2012 was negative 0.1 percent, declining to negative 0.4 percent in the second quarter, then briefly rebounding to positive 0.9-percent growth in the third quarter before dipping again in the fourth quarter to negative 0.3-percent growth, and finally closing out the year with an average 0.9-percent growth. While the 2012 Olympic Games boosted the U.K. economy and helped support growth in the third quarter, a host of issues clouded the year's

economic story. Reduced mining and quarrying activity brought about by delays in maintenance at the North Sea facilities, combined with weaker demand from a Europe still afflicted by a sovereign debt crisis, and severe domestic austerity, resulted in sluggish economic activity. Nevertheless, the United Kingdom avoided a triple-dip recession, posting positive 0.3-percent growth in the first quarter of 2013. Whether this positive growth can be sustained remains to be seen; the U.K. government is strongly opposing local political pressure against austerity measures. Meanwhile, debt-reduction efforts failed to decrease the U.K. debt-to-GDP ratio, which continued to increase due to sluggish GDP growth, reaching a record high of 90.7 percent in December 2012. Real exports fell by 0.2 percent, while real imports expanded by 2.7 percent. Industrial production dropped by 2.6 percent in 2012.

The U.K. unemployment rate started the year at 8.2 percent then began to decline in the spring, reaching 7.8 percent in July 2012. The rate dipped to 7.7 percent in December 2012, but at the beginning of 2013 the rate increased again, to 7.8 percent, where it remained until April. Some 602,000 jobs were added in 2012. Consumer price inflation dropped to 2.2 percent in September 2012—a 3-year low.

Prospects for economic growth in the United Kingdom remain difficult. The country will continue to struggle to reach significant sustainable growth given its very tight fiscal policy combined with economic problems in the eurozone and low economic growth worldwide. Considerable uncertainty about the outlook adds to the problems for the financially driven U.K. economy. Real wages have increased very slowly, limiting the scope for consumer demand as the engine of growth; employment growth

slowed in early 2013. Growth is expected to be just 0.7 percent in 2013, rising to 1.5 percent by 2014.

### ***Bilateral Trade Overview***

The diminishing importance of the United Kingdom as a trading partner for Canada has been apparent for some time, and was especially manifest in 2012, when China, Canada's second-largest trading partner, replaced the United Kingdom as Canada's second-largest export destination. Canada's exports to the United Kingdom remained constant in 2012, at \$18.8 billion, and were passed by rapidly growing exports to China. The main component of these exports, precious stones and metals (mostly gold), has been buoyed by rising prices for the past few years, but a stop to that tendency made exports flat in 2012, with only 1.7 percent growth (\$13.5 billion in total). Exports in that category constituted 71.8 percent of Canada's total exports to the United Kingdom. Uranium exports, a distant second, lost 9.9 percent of value in 2012 as uranium prices decreased; nickel exports, the third-largest category, lost 26.4 percent of value as prices dropped. By contrast, exports of aircraft and parts rose by 39.0 percent, while exports of mineral fuels and oil more than doubled, as an unusual shipment of crude oil to the United Kingdom was recorded.

On the import side, the United Kingdom was Canada's sixth-largest import source, although imports from the U.K. lost 17.3 percent of value in 2012, declining to \$8.5 billion. This was primarily due to the halving of mineral fuel and oil imports, down \$1.3 billion, on the year. Mechanical machinery imports declined by 25.0 percent; imports of pharmaceuticals, the third-largest category, also declined, by 5.9

percent. Imports of automotive products rose 33.4 percent; imports of precious stones and metals declined considerably, by 34.8 percent.

The days when the United Kingdom was Canada's largest trading partner are long gone, and its importance as a destination for Canada's exports is largely concentrated in the technical gold trade; if another destination were to be found, Canada's exports to the United Kingdom would likely shrink by over two thirds, from \$18.8 billion in 2012 to \$5.3 billion - below the level of exports to Mexico.

## **Regional Overview**

### **Emerging Asia**

In 2012, emerging Asia was again the fastest-growing region, with real GDP growth reaching 6.6 percent, which was down from 8.1 percent in 2011. This trend reflects the cooling economy in China in proportion to the decline, the more-than-proportionate fall in India's output from 7.7 percent in 2011 to 4.0 percent in 2012 and the surprisingly strong growth among the ASEAN-5<sup>1</sup>, rising from 4.5 percent in 2011 to 6.1 percent in 2012.

Indonesia and the Philippines, the most populous countries among the ASEAN-5, posted some of the strongest GDP growth. The Philippines' economy grew robustly, up 6.6 percent in 2012, while Indonesia's grew at 6.2 percent. Thailand was the other strong performer, with real GDP increasing by 6.4 percent. Favourable demographics are among the fundamentals that will continue to support expansion over the short-, medium-, and long-term in these countries, often in spite of unfriendly business environments. Investment in Indonesia, for example, has been booming,

1 The Association of South East Asian Nations-5 (ASEAN-5) comprises Indonesia, Malaysia, the Philippines, Thailand and Vietnam.

reaching a record high of US\$22.8 billion, despite tortuous domestic investment regulations, and is expected to increase another 35.6 percent in 2013. Domestic demand has been strong in all ASEAN-5 countries, with the possible exception of Vietnam, which according to the IMF grew an estimated 5.0 percent.

The resilience of the trade-dependent Malaysian economy surprised on the upside in 2012. Despite the softening of demand for electronic products, its main export, new investment projects and strong domestic demand accelerated growth to 5.6 percent for the year. Whereas Indonesia's policy improvements seem to be on hold in the short-term, the course of reforms in Malaysia depends largely on the results of the general election.

Prospects have improved for the Philippines, according to analysts' estimates, propelled by its favourable demographics, stable flows of remittances (over 10 percent of GDP in 2012) and competent technocratic management of the economy. Thailand has fully recovered from the devastation of the 2011 flooding, with key investors recommitting to their projects there, and is therefore well-positioned to be a key link in Southeast Asian value chains. Vietnam's sub-trend growth points to structural issues in its economy and the need for reform in the government-owned enterprises and the financial sector. Growth crashed to 1.3 percent in Singapore, which is undergoing policy-led economic restructuring; this process is expected to continue in 2013, with above-5-percent growth returning by 2014.

Prospects for the region continue to be favourable, but declining as most countries have a specific set of economic policy issues to deal with before stronger growth will be possible. Robust 5.9-percent growth is expected in 2013,

slowing down to 5.5 percent in 2014. The need for structural reforms will slow growth, and the cooling demand from the advanced world affecting demand in China will feed through to the growth leaders of the ASEAN-5.

Fertilizer is the most important Canadian export to Southeast Asia, accounting for 16 percent of total merchandise exports (over \$1 billion) to the region in 2012. Analysts predict that the recent deal between Canpotex Ltd., which sells potash outside of North America for PotashCorp and the U.S. firm Mosaic, and China's Sinofert will help set the pricing standard for other buyers, which will now move into market. Southeast Asian purchases of this commodity, and Canada's overall merchandise exports to the region, could thus be set to expand in 2013. A large decrease in the exports of copper ore to the Philippines, due to the major fire at the ordering refinery, is expected to be reversed next year.

### **Eurozone**

The European crisis continued on its irresolute course in 2012, but progress was made on the financial front as the European Central Bank (ECB) took decisive action to assure investors that the ECB stood behind Italy's and Spain's debts, driving down their bond yields and shoring up confidence in the euro. Nevertheless, the underlying issues continued to pressure the fiscal balances of the smaller EU economies, with another flare-up in early 2013 as the Cypriot banking system faced bankruptcy. The associated bailout proposals have to some degree undermined confidence among Europeans in the safety of their bank deposits, and have increased systemic uncertainty.

While the financial crisis has arguably lessened, the economic crisis continues unabated. Eurozone again slid into recession in 2012,

with a negative 0.6-percent growth, driven by tight fiscal policy causing lack of aggregate demand and high unemployment. Ironically, the declared priority of the eurozone members of shoring up the fiscal balances is not being met either, as the sliding GDPs and tax revenues that characterize recession-bitten economies dried up the tax revenues and increased, rather than reduced, the debt-to-GDP ratios in many countries. Economic prospects for 2013 largely depend on a major shift toward growth-oriented policies, which to some extent may be occurring already in France and Italy, and here is why the success or failure of Japan's example in its chosen course of fiscal and monetary expansion is so important.

Growth in the eurozone is expected to be negative 0.3 percent in 2013, but to improve to positive 1.1 percent growth in 2014. Germany's real GDP increased 0.9 percent in 2012 and is predicted to slow to 0.6 percent in 2013 before recovering to 1.5 percent in 2014. GDP growth in France flatlined in 2012, then is expected to edge down 0.1 percent in 2013 and to return to 0.9-percent growth in 2014. Italy's GDP dropped 2.4 percent in 2012 and is projected to lose another 1.5 percent in 2013 before returning to 0.5-percent growth in 2014. To some extent, these figures are contingent on current policies and may be subject to faster improvement if these policies change; at the same time, downside risks remain if the financial crisis gets out of control again or if the demand from the emerging markets weakens.

Trade among the EU-27 contracted in 2012, with exports going down 5 percent and imports 6 percent, primarily because the member countries traded less with each other as the recession dampened import demand. Canada's exports to the major eurozone countries declined for the

same reason, with the exception of exports to France—which grew by 2.3 percent—although these were buoyed by the large increase in the exports of mineral oil and fuels, which more than doubled. Exports to the Netherlands, Canada's top eurozone export destination, fell 5.5 percent; exports to Germany fell 9.5 percent; exports to Belgium fell 3.3 percent; exports to Italy fell 13.3 percent; and exports to Spain fell 5.9 percent. Overall, Canadian imports from the eurozone increased; however, once again France was the exception with imports that fell 9.7 percent. Imports from Germany increased 11.7 percent; imports from Italy increased 2.3 percent; and imports from the Netherlands grew a hefty 38.4 percent. Demand for specialized, niche European products continues to be strong in Canada, whereas the demand for Canadian goods in Europe is temporarily dampened by the current economic situation in Europe, although with an occasional prospect for market opportunities such as the one in France.

### **Emerging Europe**

After strong growth of 5.2 percent in 2011, Emerging Europe decelerated to just 1.6-percent real GDP growth in 2012. The eurozone's sovereign debt problems continue to affect this region, primarily through its strong financial links with Europe. As many financial institutions operating in Eastern Europe are subsidiaries of the eurozone banks, the solvency issues come into play every time the financial crisis in the eurozone returns. Restricted funding also makes growth more dependent on domestic sources of financing and demand. Production links matter a great deal too as the region continues to integrate with Western Europe. The region as a whole is expected to accelerate, achieving 2.2-percent growth in 2013 and 2.8-percent growth in 2014.



Canada and Emerging Europe do not share very strong trading links. Turkey is Canada's largest trading partner in Emerging Europe; Canada's exports fell by a third in 2012, near the 2010-level, to stand at \$850 million. Primary export articles include coal, ferrous wastes and scrap, and leguminous vegetables; declines in these three categories accounted for the majority of the decline in exports. Poland is Canada's second-largest export destination in the region; exports to Poland increased by 77 percent in 2012 to reach \$445 million; a large order of aircraft was responsible.

Canada's imports from Turkey were valued at \$1.5 billion in 2012, more than double the 2010 value. Sales of bars of iron and steel, gold, and trucks, Canada's chief import commodities from Turkey, were booming and drove the expanding trade. Imports from Poland fell 24 percent from 2011 to \$1.1 billion in 2012, of which mechanical machinery accounted for half, largely aircraft engine parts. The overall decline was wholly due to the near-discontinuation of imports of silver, which amounted to half a billion dollars in 2011.

Overall, given its variety and development stage, the region offers opportunities for Canadian exporters; difficulties include under-developed infrastructure and the eurozone's advantageous physical and cultural proximity facilitating the seizing of business opportunities in the region. However, as the eurozone staggers through its crisis, its attention and ability to act upon opportunities in Emerging Europe may be limited, making this a good time for Canada to explore these opportunities and integrate itself into some value chains running through this region.

### **Latin America and the Caribbean (LAC)**

The economy of the LAC region continued to slow in 2012, with only 3.0-percent growth for the year. This deceleration followed the 6.1-percent rebound in 2010 and the respectable 4.6-percent rise in 2011. Commodity prices sagged in 2012, constraining growth for many resource-based economies in the LAC region. Growth is forecast to pick up in 2013 and 2014, with rates of 3.4 percent and 3.9 percent, respectively.

The growth story for the region was uneven. Mexico, with its strong links to the United States, benefited from the returning strength of the U.S. economy and posted stable growth of 3.9 percent in both 2011 and 2012. Mexico's automotive industry continued to expand its market share in the United States, but recent capital inflows pushed the value of the peso upwards. Oil production in the country is continuing to decline, biting into the fiscal balance; growth is expected to decelerate to 3.4 percent for both 2013 and 2014, and some economic reforms are expected to take place in this period as well.

Brazil has stumbled, going from 7.5 percent growth in 2010, down to 2.7 percent in 2011, and further down to just 0.9 percent in 2012; a decline in fixed investment was largely to blame. As fiscal stimulus and strong consumer demand take hold, the economy is expected to do better in the short-term, accelerating to 3.0 percent in 2013, and to 4.0 percent in 2014, the year the FIFA World Cup will be held in Brazil—an event that is expected to spur investment considerably and to add revenues and increase trade.

Long-term prospects are also favourable to countries with well-managed economies and substantial foreign investment flows - Chile, Peru and Colombia. By contrast, growth is expected to be slower in Argentina, Venezuela, and Ecuador due to government interference and questionable economic policies in these countries, although their governments are nevertheless addressing income inequality, one of the LAC region's long-term challenges. Other challenges for LAC include inadequate infrastructure and restrictive business environments. The region remains rather insulated from the direct effects of the crises in the rest of the world, with commodity prices being the strongest influence on the regional economy, although financial linkages with European banks are strong, and trading links are being forged with Asia.

Canada's trade with the region centres on Mexico and Brazil, the pillars of our commerce in LAC. Thanks to NAFTA, Mexico is becoming more strongly integrated into the North American value chains each year; Canada's exports to Mexico reached \$5.4 billion in 2012, making it our fifth-largest export destination. These exports remained largely stable in 2012, showing considerable variety due to proximity; the top articles are canola seeds, automotive products, electrical and mechanical machinery, iron and steel, wheat, and aluminum. Imports from Mexico were much larger, totalling \$25.5 billion (up 3.8 percent in 2012) and accounted for Canada's second-largest trade deficit (after China). These imports are mostly trucks (whose manufacturing is part of the North American automotive value chain positioned strategically in Mexico), motor vehicle parts and electrical machinery (reception apparatus and telephone sets). Canada's major imports from Mexico also include mechanical machinery and mineral fuels and oil. Exports to Brazil went down 9.2

percent in 2012, to \$2.6 billion; these exports primarily consisted of commodities such as potash, coal and mechanical machinery. Imports from Brazil went up 3.5 percent to reach \$4.0 billion; crude oil, aluminum oxides and cane sugar were the dominant commodities. With respect to Canada's trade with the rest of the region (Chile, Peru), precious metals (gold and silver) were the most important import category while coal, canola seeds and wheat were important exports.

Opportunities for Canada in the LAC region reflect Canada's traditional strength in resources, but are also somewhat hampered by the fact that many countries in the region share similar export strengths. However, as the trade picture with Brazil shows, opportunities exist in specialized areas through business consolidation leading to intra-industry trade connections. As part of Canada's trade policy, a number of trade and investment protection agreements have been signed recently reflecting our interest in the region. Canadian businesses are likely to explore the numerous opportunities conferred by these agreements in the coming years, and the TPP negotiations may nudge them further in the LAC direction.

### **Middle East and North Africa**

Middle East and North Africa (MENA) was the only region where growth accelerated in 2012, despite moderating prices for its primary export commodity, oil. Growth picked up from 4.0 percent in 2011 to 4.8 percent in 2012, reflecting a fast rebound in Libya and great economic performances by Saudi Arabia, Iraq and Kuwait. Political and social unrest has subsided in most of the region, either resolved through revolution or civil war (Libya) or through social consensus and a promise of reform (Yemen). Syria is a notable exception; the civil war there



continued to escalate, although it has been largely contained within Syria, with the spill-over to its neighbours minimal so far. Strong domestic demand and commodity exports will continue to generate economic growth in the near future, but the effects of the European recession and decreased global demand will affect the pace. Growth is expected to slow to 3.1 percent in 2013 and then pick up to 3.7 percent in 2014; the slowdown will primarily affect oil exporters—Saudi Arabia, the United Arab Emirates (U.A.E.), Iraq and Kuwait—as crude prices decline further in 2013-14. Iran is expected to achieve positive growth by 2014.

Canada's trade interests in the region are considerable. The U.A.E. remains Canada's largest export destination in the region, with \$1.5 billion in exports: canola seeds, aircraft and wheat constitute the core of Canada's exports to the U.A.E. Saudi Arabia was a close second last year as Canada's total exports there were up 61.1 percent to \$1.4 billion, largely due to a \$416-million shipment of armoured fighting

vehicles. Cereals, machinery, and ores and ash are historically Canada's top export categories to Saudi Arabia. On the import side, Canada's demand is predominantly for crude oil; Canada's crude oil imports from Algeria make it Canada's eighth-largest import partner, with imports worth \$6.0 billion. In 2012, oil imports totalled \$4.0 billion from Iraq and \$2.8 billion from Saudi Arabia. Imports from the U.A.E. are more varied, comprising some articles of base metal, machinery parts and jewellery; imports of oil from that country consist of refined oil and its by-products. Canada's construction and engineering firms have also been active in the region, specifically in the provision of services and associated goods; additional opportunities in this area may arise.

## World Merchandise Trade Value Rankings

China was the world's top merchandise exporter for the fourth consecutive year, accounting for 11.2 percent of global trade. China's exports

**TABLE 2-1**  
Leading Exporters and Importers in World Merchandise Trade, 2012  
(US\$ billions and %)

2012 Rank	2011 Rank	Exporters	2012 US\$B Value	2012 % Share	2012 Rank	2011 Rank	Importers	2012 US\$B Value	2012 % Share
1	1	China	2,049	11.2	1	1	United States	2,335	12.6
2	2	United States	1,547	8.4	2	2	China	1,818	9.8
3	3	Germany	1,407	7.7	3	3	Germany	1,167	6.3
4	4	Japan	799	4.4	4	4	Japan	886	4.8
5	5	Netherlands	656	3.6	5	6	United Kingdom	680	3.7
6	6	France	569	6.1	6	5	France	674	3.6
7	7	South Korea	548	3.0	7	7	Netherlands	591	3.2
8	9	Russia	529	2.9	8	10	Hong Kong	554	3.0
9	8	Italy	500	2.7	9	9	South Korea	520	2.8
10	12	Hong Kong	493	2.7	10	13	India	489	2.6
12	13	Canada	455	2.5	12	11	Canada	475	2.6

Source: WTO Secretariat

passed the \$2-trillion mark, with exports totaling \$2,049 billion—ahead of the United States by just over \$500 billion.

The United States held second place in the export rankings, just ahead of Germany, with a total export value of \$1,547 billion; the U.S. share of world exports rose to 8.4 percent in 2012. Germany's exports totalled \$1,407 billion, or 7.7 percent of world exports.

Japan ranked a distant fourth, with \$799 billion in exports, about half the value of U.S. exports. Japan's share of the world export market edged down from 4.5 percent in 2011 to 4.4 percent in 2012.

The value of exports from the Netherlands remained essentially unchanged (\$656 billion) while France's exports dropped to \$569 billion, but these two countries retained their fifth and sixth rankings, respectively. The world share of exports from the Netherlands remained at 3.6 percent, while France's share slipped from 3.3 percent to 3.2 percent.

South Korea has held seventh place since 2010, retaining its 3.0-percent global market share with exports of \$548 billion, almost unchanged from 2011.

Russia nudged Italy out of eighth place in world export rankings, with \$529 billion in exports and a 2.9-percent share of world exports. Italy slipped to ninth place, holding a 2.7-percent share of world exports as exports declined from \$523 billion to \$500 billion.

Hong Kong rose to tenth place in 2012, with \$493 billion in exports and a 2.7-percent world share. Canada overtook Belgium, rising from 13th to 12th place (2.5 percent of world exports) and posting \$455 billion in exports.

On the import side, the rankings were similarly stable. The United States continued to top the world charts, with \$2,335 billion in imports, and the U.S. share of world imports expanded from 12.3 percent in 2011 to 12.6 percent in 2012. China remained in second place, with \$1,818 billion in imports (9.8 percent of the world share), and Germany ranked third, with imports valued at \$1,167 billion (6.3-percent share).

Japan, in fourth place, imported \$886 billion worth of merchandise, increasing its share of world imports to 4.8 percent. The United Kingdom passed France to claim fifth place, with \$680 billion in imports and a 3.7-percent global share. France dropped to sixth place, with \$674 billion in imports; its global share declined to 3.6 percent. The Netherlands held seventh place, with imports of \$591 billion.

Hong Kong reversed its decline, rising from tenth to eighth place, while Italy, which held eighth place in 2011, slipped out of the top ten in 2012. Hong Kong's imports totalled \$554 billion, or 3.0 percent of the world total. South Korea retained ninth place, with imports of \$520 billion (2.8-percent share), while India jumped three spots to land in tenth place, with imports of \$489 billion. Canada went one step down in the rankings with \$475 billion in imports (2.6 percent of world imports).

## World Services Trade Value Rankings

The United States was the world's leading services trader for both exports and imports in 2012, exporting \$614 billion worth of services (14.1-percent global share) while importing only \$406 billion (9.9-percent global share). The U.S. global share of services exports rose while its share of imports fell in 2012. The

**TABLE 2-2**  
Leading Exporters and Importers in World Services Trade, 2012  
(US\$ billions and %)

2012 Rank	2011 Rank	Exporters	2012 US\$B Value	2012 % Share	2012 Rank	2011 Rank	Importers	2012 US\$B Value	2012 % Share
1	1	United States	614	14.1	1	1	United States	406	9.9
2	2	United Kingdom	278	6.4	2	2	Germany	285	6.9
3	3	Germany	255	5.9	3	3	China	281	6.8
4	5	France	208	4.8	4	4	United Kingdom	176	4.3
5	4	China	190	4.4	5	5	Japan	174	4.2
6	6	India	148	3.4	6	6	France	171	4.2
7	7	Japan	140	3.2	7	7	India	125	3.0
8	8	Spain	140	3.2	8	11	Singapore	117	2.8
9	10	Singapore	133	3.1	9	8	Netherlands	115	2.8
10	9	Netherlands	126	2.9	10	10	Ireland	110	2.7
17	18	Canada	78	1.8	11	12	Canada	105	2.6

Source: WTO Secretariat

United States also posted the world's biggest trade surplus in services, with exports exceeding imports by \$208 billion.

The United Kingdom kept the second spot in export rankings that it took from Germany in 2011, with \$278 billion in exports and a 6.4-percent world share. Germany held third place, with \$255 billion and a 5.9-percent share. In an unusual development, China was passed by France, which took over the fourth place with \$208 billion in services exports (4.8-percent global share). China dropped to fifth place in global rankings, with exports of \$190 billion (4.4-percent share).

India held sixth place and a 3.4-percent share of the world's services exports, with exports of \$148 billion, unchanged from last year. Japan and Spain, each with \$140 billion in services exports, held seventh and eighth spots, respectively. Singapore reclaimed the ninth spot it lost to the Netherlands in 2011, posting \$133

billion in services exports; the Netherlands went back to tenth spot, with \$126 billion in services exports and a 2.9-percent world share. Canada went up a rank to 17th place, increasing its services exports from \$74 billion to \$78 billion (1.8-percent world share).

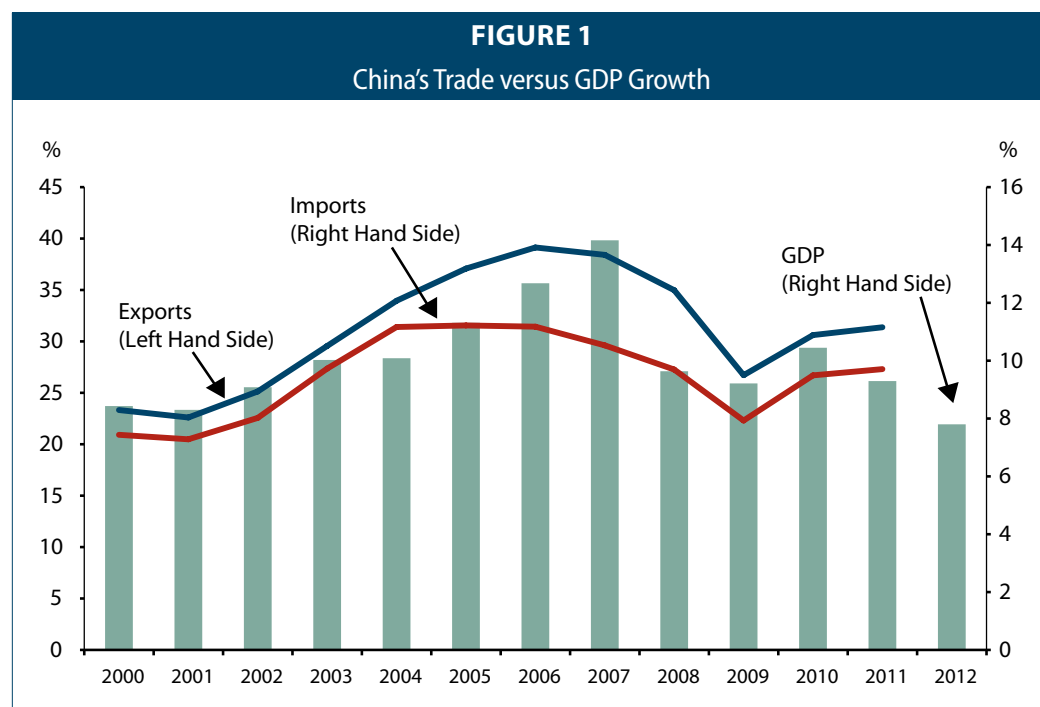
On the import side, Germany held second place, with services imports of \$285 billion, or 6.9 percent of the world's total. China was close behind, with \$281 billion in imports. The United Kingdom (\$176 billion in services imports), Japan (\$174 billion) and France (\$171 billion) occupied spots four to six, followed by India, with \$125 billion in services imports. Singapore jumped three places to claim the eighth spot, with \$117 billion in services imports; the Netherlands slipped to ninth place, with \$115 billion, and Ireland remained tenth with \$110 billion. Canada climbed another notch, from 13th in 2010, to 12th in 2011, to 11th in 2012, with \$105 billion in services imports, a 2.6-percent global share. ■

## China's Share of Canadian Merchandise Trade: Holding Steady for Now

### Overview

China, the world's largest merchandise exporter—responsible for roughly 11.2 percent of the world's merchandise exports in 2012—is undergoing an economic transition that will have consequences on trade worldwide. The impact of this transition on Canada's trade with China will be twofold. First, as China moves away from export-led growth and refocuses its efforts on building up its domestic demand, growth of Canada's and the world's imports from China will likely slow down. Indeed, China's annual merchandise export growth to the world in the post-recession period has already decreased by five percentage points compared with the pre-recession period.<sup>1</sup> Secondly, the basket of goods and services China demands from its trading partners, including Canada, will change, as domestic consumption and urbanization increase in China, and the typical Chinese consumer becomes more sophisticated.

China is set on achieving its goal of rebalancing and transitioning into a more developed market. Thus, the slowing in China's GDP growth since the global recession, along with

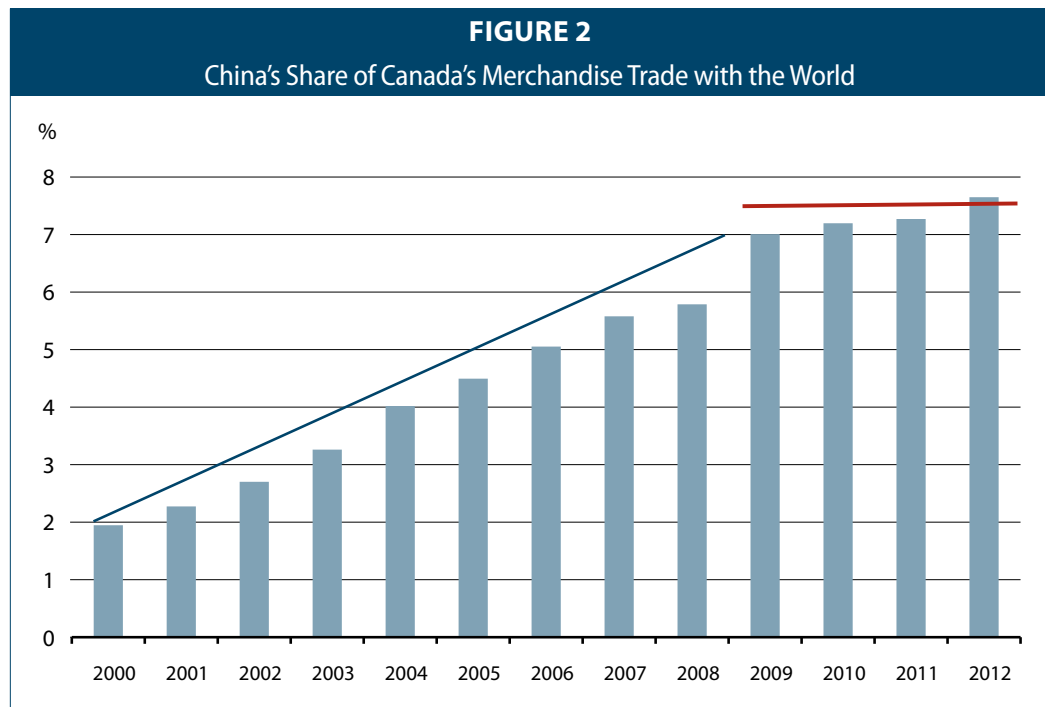


1 In the pre-recession period of 2000-2008, China's merchandise exports averaged 19.3 percent annual growth; in the post-recession period, this growth declined to 14.6 percent.

the reduction of China’s trade as a share of GDP, will likely continue.<sup>2,3</sup> However, although China’s transition to a domestically driven economy will undoubtedly change the structure of its trading relationship with Canada, China’s relative importance to the global economy will ensure that China remains an immensely significant trading partner for Canada.

### Total Trade

Although Canada’s trade with China expanded from \$15 billion to \$70 billion between 2000 and 2012, growth in Canada-China trade has slowed somewhat since the recession. Between 2000 and 2008, annual growth in Canada-China merchandise trade averaged 17 percent, but between 2009 and 2012, growth slowed to 11 percent, and in 2012 growth was only 8 percent. By contrast, Canada’s average annual trade with countries other than China grew faster between 2009 and 2012 (8 percent) than between 2000 and 2009 (2 percent). Since 2009, China’s share of Canada’s trade has hovered between 7 percent and 8 percent. Although the global crisis may have contributed to slowing growth in trade between Canada and China, the downward trend could also indicate that China is moving toward a more balanced economy, based increasingly on domestic consumption rather than export growth.



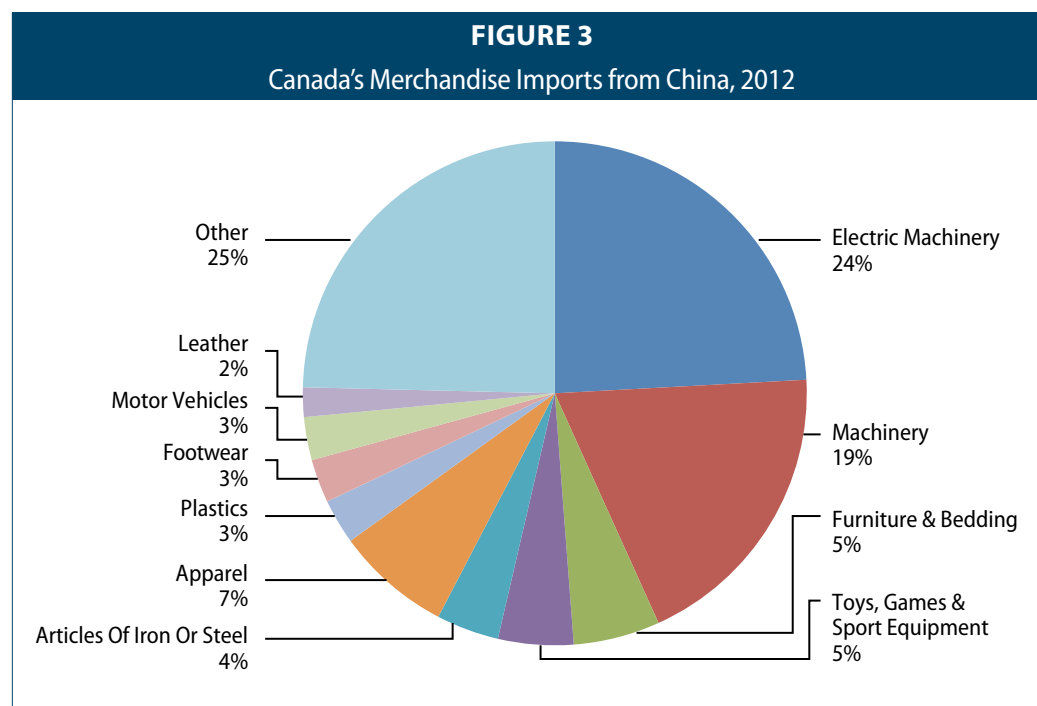
2 The National People’s Congress of the People’s Republic of China, “Report on China’s Economic, Social Development Plan,” March 19, 2013.

3 China’s growth has largely been export-driven, and is currently negatively affected by the weakness of the global economy.

## Imports

Canada's imports from China contributed the most to Canada-China two-way trade between 2000 and 2012, making up, on average, 78 percent of the total trade. Canada's imports from China mirrored the trend in China's export growth to the world, growing more rapidly between 2000 and 2008 (18 percent annual average growth) than in the post-recession period (9 percent average annual growth). In 2012, Canada's imports from China grew 5 percent to reach \$51 billion. The downward trend notwithstanding, China remains Canada's second-largest source of merchandise imports, a position it has held since 2002. With the recent slow-down in the growth of Canada's imports from China, China's share of Canada's merchandise imports has remained steady at around 11 percent since 2009.

The composition of Canada's imports from China has become increasingly sophisticated. For example, imports of toys and of apparel each declined by at least 5 percent in 2012 while imports of electrical machinery and motor vehicles increased by 8 percent and 20 percent, respectively; computers and cell phones continued to be Canada's top merchandise imports from China in 2012. In fact, China was Canada's largest source of telecom products in 2012, with a 57-percent market share (although it is important to note that China relies heavily on imported inputs to manufacture its exports).<sup>4</sup>

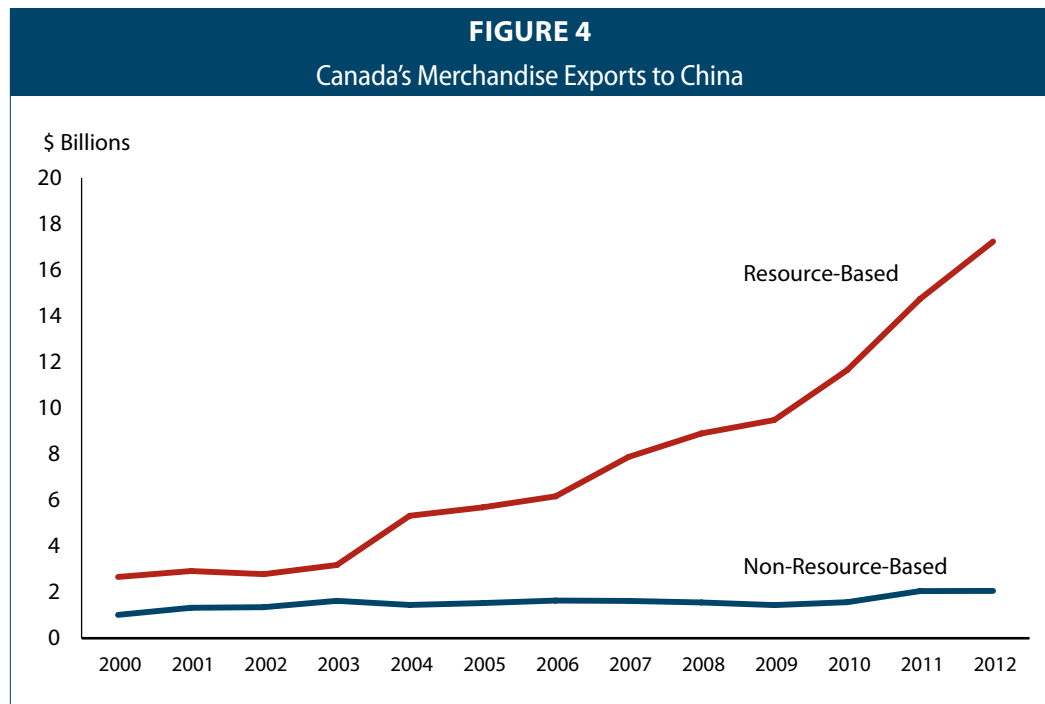


<sup>4</sup> Ma, Alyson, and Ari Van Assche, "China's Role in Global Production Networks," *Global Value Chains: Impacts and Implications, Trade Policy Research*, 2011.

### Exports

While China has remained Canada’s second-largest trading partner for over a decade, China only became Canada’s second-largest export market in 2012, when Canada’s exports to China reached \$19 billion—an increase of 15 percent year-over-year. Unlike imports, Canada’s exports to China underwent greater growth in the latter half of the decade: between 2000 and 2008, Canada’s exports to China registered an average annual growth rate of 14 percent, while in the post-recession period exports grew at an average annual rate of 20 percent. Canada’s exports to China also accounted for most of the growth in Canada’s exports to non-U.S. destinations between 2009 and 2012; in other words, Canada’s share of total exports to non-U.S. destinations remained around 25 percent entirely because of China’s growing importance as an export destination for Canada. Since 2008, Canada’s merchandise exports to China as a proportion of Canada’s total exports has almost doubled, from 2.2 percent to 4.3 percent, and also increased from a 10 percent share of exports to non-U.S. destinations in 2008 to a 17-percent share in 2012.

Between 2006 and 2012, four main groups or “emerging commodities” accounted for 47 percent of the growth of Canada’s merchandise exports to China: ores (HS 26), wood (HS 44), fuels (HS 27), and vegetable oils and seeds (HS 12 and 15). All four of these commodity groups are resource-based. Indeed, when Canada’s exports to China are classified according to their resource content, the share of Canada’s resource-based exports to China compared to its non-resource-based exports has steadily increased over the last decade, from 72 percent in 2000 to 89 percent, or \$17 billion, in 2012.





## Trade Balance

The \$31-billion bilateral trade deficit remained largely unchanged between 2011 and 2012 and has hovered around \$30 billion for the last six years. As in the case of total trade, the trend toward slowing growth in Canada's imports from China may indicate that China is transitioning toward a more balanced growth model that relies less on exports.

## Outlook

As China shifts from a model of export- and investment-led growth toward one relying more on domestic consumption, slower GDP growth may be expected. In 2012, China's GDP already registered a growth rate of 7.8 percent, the first time it has fallen below 8 percent since before 2000. As China makes the shift toward consumption-led growth, its demand for foreign goods will likely change, as consumption-led growth requires different materials and services than investment-led growth. The growth of China's exports can also be expected to decline further. While China's economic transition may reduce its appetite for some resource-based goods, China's demand for other resource-based goods may remain strong. For example, Canada's "emerging commodities" could be linked to all parts of the Chinese economy: ores to manufacturing, wood to residential home construction (investment), and vegetable oil and seeds to private consumption. In 2012, China was the world's largest importer of Canada's ores, taking in 31 percent of Canada's exports of ores. Further, the other two emerging commodities have seen tremendous growth in exports to China in recent years: exports of wood increased 74 percent in 2011, and exports of oil seeds increased 167 percent in 2012. China's economic transition may also present opportunities for Canada's exporters of services as China increasingly demands more sophisticated imports. China's sheer economic size, coupled with its huge appetite for a wide range of goods and services, despite their changing composition, will cement China's position as an exceptionally important trading partner for Canada.

With respect to continued growth in urbanization, there may be some potential for a heightened demand for Canada's exports of ores, wood, and fuels. China's urban population is expected to hit 1 billion by 2030,<sup>5</sup> and will include a significant share of migrant workers. In China, these migrant workers do not enjoy the same living standards, job opportunities, and access to social services as other urban dwellers, and thus their demand for consumer products and services is lower.<sup>6</sup> However, China's policy makers have identified the need to integrate migrant workers into Chinese cities, and if the policies aimed at doing so are successful, newly urbanized migrant workers could further increase consumer demand.

5 Miller, Tom, *China's Urban Billion: The Story Behind the Biggest Migration in Human History*, Zed Books: 2012.

6 Borst, Nicholas and Ryan Rutkowski, "China's New Populist Urbanization," *Peterson Institute for International Economics: China Economic Watch*, March 19, 2013.

Canada's trade relationship with China can be expected to change, although it will be difficult to predict precisely how. As China's GDP growth slows, and China strives to achieve the goals it set out for itself in its most recent (12<sup>th</sup>) five-year plan, the types of goods and services Canada trades with China will become increasingly sophisticated and more reliant on support from consumer demand rather than investment. The Chinese government noted in a recent report that its "economic growth rate will be slower than previous years, [as] we have to address the problem of overcapacity."<sup>7</sup> Furthermore, China has stated that it will focus on boosting domestic demand by increasing workers' wages as well as supporting the structure of consumer spending by making available more "green" products. While China continues to adjust its economy, its demand may decline for some of Canada's resource-based exports yet increase for others. Therefore, as China's demand structure continues to evolve, Canada-China trade will likely provide new opportunities for Canada's exporters, especially in services. ■

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<sup>7</sup> The National People's Congress of the People's Republic of China, "Report on China's Economic, Social Development Plan," March 19, 2013.

# Canada's Economic Performance

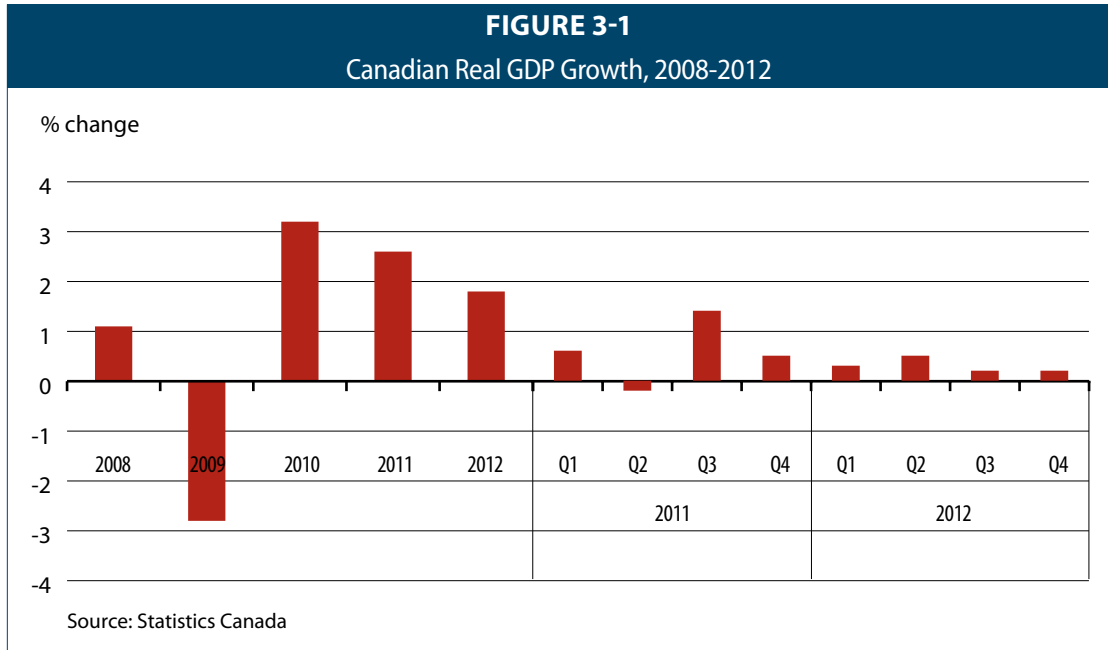
While the global economic picture went through another period of increased expectations followed by another flare-up of the European crisis and continued uncertainty, Canada's economic recovery nevertheless proceeded apace in 2012. Economic activity grew in all four quarters of the year, although it slowed down in the second half of 2012. Canada's growth in 2012 was driven by both domestic strengths and the recovery taking hold in the U.S. economy, particularly in the automotive sector. New housing construction showed double-digit growth while business investment continued to grow robustly. Additionally, over 300,000 new jobs were added during the year, bringing the number of jobs gained since the recession trough to nearly a million. As the rise in prices of food and energy came to a halt and the manufacturing sector continued operating below capacity, the Bank of Canada maintained an easy monetary policy that was more limited by concerns about household debt than about inflationary pressures. Canada's long-rising household debt showed signs of slowing down, although the household debt-to-income ratio still hit a record high of 165 percent at the end of the year.

Canada's performance through the recovery so far has been very solid—the best in the G-7 in both employment growth (up 6.0 percent) and real GDP growth (up 8.9 percent). The budget deficit for fiscal year 2012/13 is now expected to come in at \$25.9 billion. Canada continues to be the country with the strongest fiscal position in the G-7. The International Monetary

Fund (IMF) projects Canada's total net debt-to-GDP ratio will be at about one-third of the G-7 average in 2016.

## Gross Domestic Product

Canada's economic recovery from the global recession of 2009, when real GDP contracted 2.8 percent, continued in 2012 with the economy growing by 1.8 percent for the year. While the recovery proceeded at a slower pace than in 2010 and 2011—when the rates of growth of real GDP were 3.2 percent and 2.6 percent, respectively—the recovery was more stable and the economy showed growth in every quarter of the year (Figure 3-1). A slowdown in activity in the second half of the year mirrored the troubling economic conditions and uncertainty in the global economy. The European austerity programs and the concomitant recession reduced demand, while output in Japan contracted further. Emerging markets continued to grow the fastest, but not at the rates of 2010–2011 as several of them experienced flagging output, high unemployment, lower terms of trade and the need for reforms to sustain further growth. All of these factors have contributed to reducing Canadian global exports in the second half of the year and to restraining growth in business investment. At the same time, the record-high household debt levels in Canada might have cautioned the households to slow down on consumption. Meanwhile, the persistent strength of the Canadian dollar continued to exercise an encouraging effect on imports while slowing down exports. Export prices have also been



stagnating, as Canadian crude continues to be affected by heavy discounts, partly due to the bottlenecks and transportation constraints in the interior of the continent.

**Contributions to Real GDP Growth**

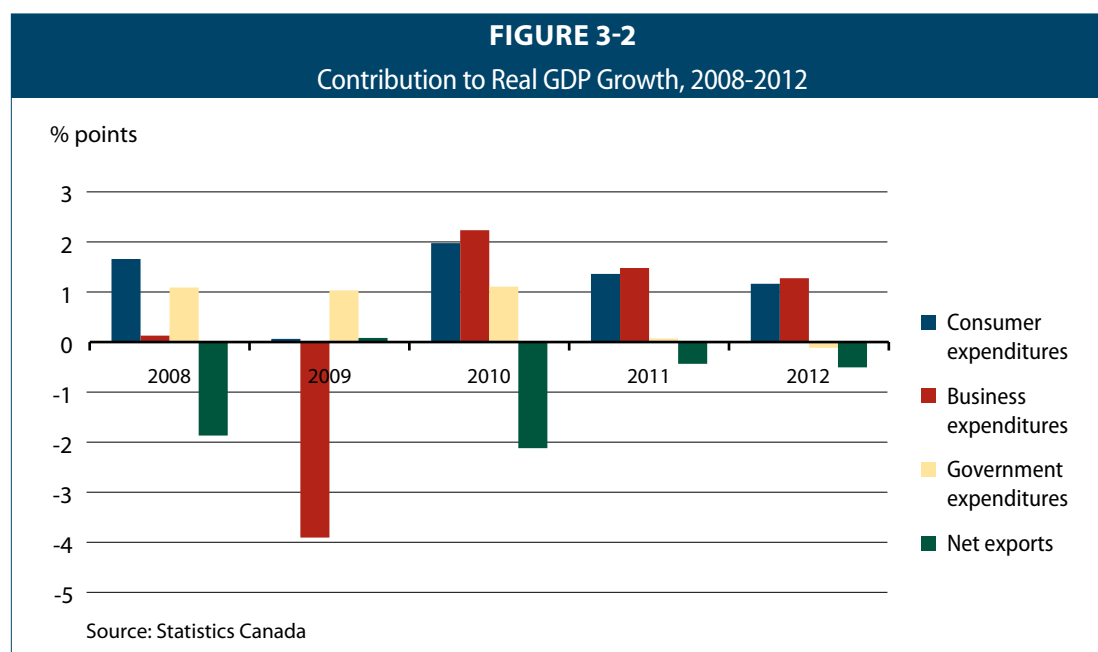
Analysis of the expenditure components of GDP (Figure 3-2) for 2012 shows a very similar picture to the year 2011, but with slightly poorer performance by all components. Most of the GDP growth in 2012 again came from the growth of business expenditures, which contributed 1.28 percentage points to the increase in real output (0.2 percentage point less than in 2011). Total business investment exhibited continued robust growth, adding 6.5 percent for the year.

Growth in business investment in 2012 was fairly broad-based. Investment in machinery and equipment, which drove the growth in the previous year, slowed down to 3.7 percent in 2012. Growth in investment in industrial machinery was stronger than the average at 5.4 percent, while investment in computers and

other electrical and electronic machinery and equipment slowed down to 1.6 percent and 1.9 percent, respectively. Following 11.1-percent growth in 2011, investment in trucks, buses and other motor vehicles actually declined 1.1 percent in 2012. Meanwhile, investment in passenger cars picked up (6.4 percent growth) as did investment in aircraft and other transportation equipment (5.0 percent growth).

Business investment in non-residential structures (e.g. manufacturing plants) exhibited one of the fastest rates of growth, increasing 8.0 percent in 2012. Investment in engineering structures was behind this growth, with a 9.0-percent increase, while investment in buildings grew more slowly at 5.0 percent.

Investment in residential structures took off again in 2012, adding 5.8 percent after a sluggish growth of 1.9 percent in 2011. Growth in the value of new housing construction was particularly robust (up 12.8 percent); however, renovations (up 1.3 percent) and ownership transfer costs (down 0.9 percent) stagnated.



Investment in intellectual property declined in 2012, down 0.7 percent (after a 9.0-percent increase in 2011). The pace of growth in mineral exploration and evaluation, buoyed by high oil prices, reached 21.2 percent in 2011; last year it declined by 3.0 percent as resource prices moderated. Investment in research and development also declined, from 8.1 percent in 2011 to 2.3 percent in 2012. Negative growth was observed in software investment (down 1.1 percent in 2012, compared with 2.8-percent growth in 2011).

The restocking of inventories gathered further speed in 2012. Business investment in inventories more than tripled, rising from \$1.6 billion in 2011 to \$5.5 billion in 2012. Nevertheless, investment in farm inventories continued to decline (down \$1.1 billion on the year, mostly due to falling grain inventories). Business investment in non-farm inventories expanded from \$2.4 billion in 2011 to \$7.2 billion in 2012. Most of that increase occurred in the wholesale sector inventories of non-durable goods (up \$2.3 billion), while wholesale

inventories of durable goods remained constant. The opposite was the case in retail: inventories of durables grew by \$2.0 billion (largely motor vehicles), while inventories of non-durables declined by \$0.04 billion. Manufacturing inventories of durables rose by \$1.1 billion, while manufacturing inventories of non-durables increased by \$0.3 billion.

Real personal expenditures on consumer goods and services slowed down in 2012, showing an increase of 1.9 percent, following 2.4-percent growth in 2011. This added 1.2 percentage points to real GDP growth in 2012, a reduction of 0.2 percentage point from the previous year. Growth in expenditures was highest for durable goods, which increased 2.8 percent. Growth in services and semi-durables expenditures was slower at 2.2 percent and 2.1 percent, respectively. Expenditures on non-durable goods increased by only 0.9 percent. Consequently, expenditures on durables contributed more to GDP growth in 2012 than in 2011, but that was completely offset by the smaller contribution of semi-durables and non-durables.

Among major sectors, real consumer expenditures on new passenger cars as well as major durables for recreation and culture rose the most in 2012, with a 4.5-percent increase in spending in each. Growth in expenditures was also notable in hospitals (up 3.2 percent), rental fees for homes (up 3.2 percent), information processing equipment (up 1.9 percent), household appliances (up 1.8 percent) and communication equipment (up 0.9 percent). Net expenditures abroad also grew by 10.7 percent. By contrast, during 2012 declines occurred in expenditures on operations of transport equipment (down 0.3 percent), implicit financial services (down 4.5 percent) and newspapers and periodicals (down 4.0 percent).

Government consumption grew 0.4 percent during the year and contributed positively to growth in real GDP (up 0.1 percentage point); however, government investment decreased by 5.6 percent and subtracted 0.2 percentage point from overall growth. Thus the total government contribution to the growth in real GDP became negative in 2012 and represented a drag of 0.1 percentage point on total output, the first negative contribution since 1997. This was a small drop from 2011, when the government contribution to GDP was a positive 0.1 percentage point.

Real exports and imports of goods and services rose by 1.6 percent and 2.9 percent, respectively. The continued slowdown in export growth decreased the contribution of exports to GDP to 0.5 percentage point in 2012, down from 1.4 percentage points in 2011. As imports slowed down by almost as much, the negative contribution from growth in real imports decreased as well, from 1.8 percentage points in 2011 to 1.0 percentage point in 2012. As a result, trade also contributed less to GDP growth in 2012

than in 2011, but only by 0.1 percentage point. The total drag of net trade on growth last year was a negative 0.5 percentage point.

Export volumes of goods and services increased by \$8.2 billion in 2012. The increase was slightly greater for goods exports, while services exports actually declined. Exports of automotive products and energy products were the main contributors to the increase, while declines were observed in chemicals and metal and non-metallic mineral products. Commercial services were behind the overall \$1.0-billion drop in services exports.

Import volumes of goods and services grew by \$15.7 billion in 2012 (up 2.9 percent), with 84 percent of the growth coming from goods imports (up \$13.2 billion, or 3.0 percent). Over half of this gain (\$7.3 billion) came from an increase in imports of automotive products. Imports of services grew by 2.4 percent in real terms, gaining \$2.5 billion. As in the previous year, travel services contributed most to the increase (up \$1.9 billion, or 5.7 percent), with commercial services following close behind (up \$1.5 billion, or 3.2 percent).

### **GDP by Industrial Activity**

In real terms, industrial activities expanded by 1.8 percent in 2012. Growth in goods production (up 1.7 percent) was nearly equal to growth in services production (up 1.8 percent).

Growth was uneven in the goods-producing sectors in 2012. Output grew in most sectors, but stagnated or declined in several other sectors. The construction sector led the growth in 2012, growing at 4.0 percent to exceed the 2011 growth level of 3.0 percent. Renewed residential construction activity was driving this

growth with a 7.1-percent increase on the year, while non-residential construction contracted by 1.0 percent.

After the economy-leading growth of 3.9 percent in 2011, utilities slowed down considerably in 2012, showing only 0.3-percent growth. The fall in natural gas distribution (down 1.2 percent) contributed the most to this decline, while growth in electric power generation and water, sewage and other systems was marginal (0.4 percent and 0.5 percent, respectively).

Activity in the mining, oil and gas extraction sector contracted marginally (down 0.1 percent) after a 5.8-percent growth in 2011. Oil and gas extraction, the main component of the industry, increased 3.6 percent during the year, while large declines in all other mining (down 4.4 percent) and support activities for mining and oil and gas extraction (down 10.5 percent) offset that increase. Among the largest declines were potash mining (down 12.8 percent); copper, nickel, lead and zinc ore mining (down 5.1 percent); and stone mining and quarrying (down 3.7 percent).

Output in the agriculture, forestry, fishing and hunting sector contracted 0.4 percent in 2012, with forestry and logging output declining by 2.6 percent and animal production by 1.1 percent. Support activities for agriculture and forestry also declined by 3.4 percent. Growth was recorded in fishing, hunting and trapping (up 3.2 percent) and crop production (up 0.9 percent).

The European crisis and the consequent uncertainty continued to dampen global demand for Canadian goods in 2012, while the recovery in the United States remained slow, but on more solid ground. Thus the growth in the volume of manufacturing output, which accounts for just

under half of the goods-producing industries, was 1.8 percent during the year 2012, slowing down a bit further from the previous year's growth rate of 2.5 percent.

Among manufacturing industries, highest growth was observed in the transportation equipment manufacturing sector (up 9.4 percent), driven by growth in motor vehicles manufacturing (up 13.8 percent) and motor vehicle parts manufacturing (up 19.1 percent). Output in the fabricated metal products sector also increased considerably (up 7.1 percent), with forging and stamping growing 12.9 percent and boiler, tank and shipping container manufacturing growing 14.4 percent.

Output also increased in the following manufacturing sectors: machinery (up 5.3 percent), particularly metalworking machinery (up 13.3 percent); beverage and tobacco product manufacturing (up 5.0 percent); wood products (up 3.9 percent in a broad-based growth); non-metallic mineral product manufacturing (up 2.9 percent), particularly cement and concrete product manufacturing (up 4.1 percent); furniture and related product manufacturing (up 2.8 percent); chemicals (up 1.8 percent); textile mills (up 1.8 percent); petroleum and coal product manufacturing (up 1.6 percent); plastics and rubber products manufacturing (up 1.6 percent); printing and related support activities (up 1.3 percent); and primary metal manufacturing (up 1.1 percent).

At the same time, declines in output were observed in several manufacturing sectors. Computer and electronic product manufacturing took the biggest hit, contracting 11.6 percent (with the communication equipment manufacturing sub-sector declining 23.1 percent). Another large decline was observed in clothing and leather and allied product manufacturing,



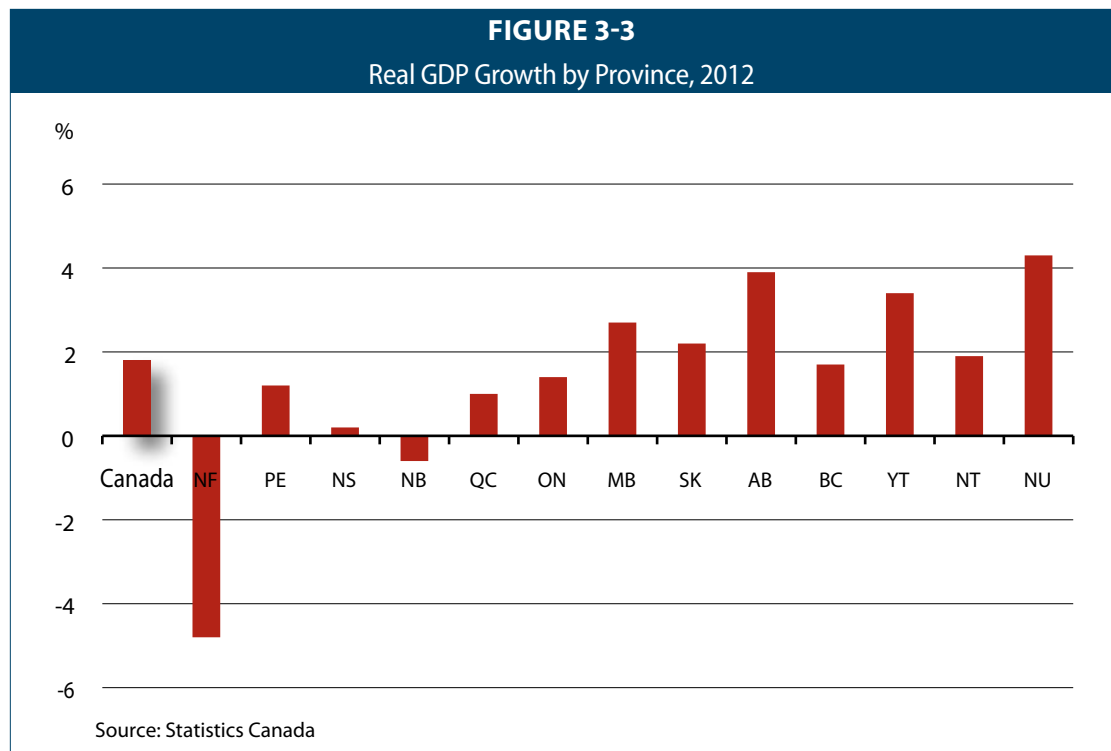
down 9.4-percent. Other sectors that declined were miscellaneous manufacturing (down 6.3 percent); paper manufacturing (down 4.7 percent); food manufacturing (down 2.7 percent); and electrical equipment, appliance and component manufacturing (down 0.4 percent). In total, 13 of the 19 major manufacturing sectors grew while 6 declined.

Output in services grew more evenly, with overall growth at 1.8 percent. Transportation and warehousing services grew 1.9 percent; real estate, rental and leasing increased 2.9 percent; and professional, scientific and technical services grew 2.0 percent. Wholesale and retail trade volumes increased by 2.2 percent and 1.5 percent, respectively. Finance and insurance grew by 2.1 percent, and health care and social assistance expanded by 2.0 percent. Management of companies and enterprises increased in output by 2.9 percent, information and cultural industries grew by 1.5 percent

and educational services increased by 1.4 percent. Arts, entertainment and recreation was the only major services sector to decline again, down 1.6 percent in 2012; public administration was also down marginally by 0.1 percent.

### Gross Domestic Product by Province

Canada's real output growth in 2012 was slower than in the previous year, and the impact was felt in most provinces and territories. Only one province (Manitoba) and one territory (Northwest Territories) did better in 2012 than in 2011. Nevertheless, eight out of ten provinces and all territories posted positive growth. Alberta, Manitoba, Nunavut and Yukon grew the fastest in 2012 due to increased oil production, mining and crop production. Newfoundland and Labrador experienced a contraction, and New Brunswick also saw negative growth last year. Output in federal



government public administration declined across most jurisdictions in Canada.

In **Newfoundland and Labrador**, real output fell 4.8 percent in 2012. A fall in oil and gas extraction due to maintenance works, as well as a decline in metal ore mining output drove this fall, although output in most major industrial sectors increased. Construction activity, in particular, rose 32 percent, and manufacturing increased by 14 percent. Service industries grew 1.9 percent on the strength of increases in retail trade, finance and insurance, and architectural and engineering services.

In **Prince Edward Island**, real GDP expanded 1.2 percent in 2012, down from a 1.7-percent increase in 2011. Fishing industry GDP expanded 33 percent and mining, oil and gas extraction increased by 71 percent. Growth was slowed by a 10-percent decline in construction, due to a fall in engineering construction. Manufacturing grew by 5 percent, with strong growth of 19 percent in machinery manufacturing and 16 percent in chemical manufacturing. Services industries grew 1.4 percent, led by education, health care, retail trade, transportation and banking services.

In **Nova Scotia**, real GDP growth was marginal, increasing 0.2 percent in 2012 after growing by 0.6 percent in 2011. Real output decreased by 4.2 percent in goods-producing industries as a result of declines in mining, quarrying, oil and gas extraction, manufacturing and electric power generation, transmission and distribution. Output in services grew by 1.2 percent, with advances in wholesale and retail trade, health care and banking and declines in federal government public administration and defence services.

**New Brunswick** was the second province for which real GDP declined, down 0.6 percent in 2012 after only 0.2-percent growth in 2011. Output fell 3.6 percent in goods-producing industries with declines in construction, mining and quarrying and the energy sector. Manufacturing output fell by 1.6 percent as most sub-sectors experienced losses. Crop production recovered, and fishing, hunting and trapping output rose as well. In services, marginal growth of 0.4 percent was driven by gains in finance, insurance and real estate services as well as in education services.

In **Quebec**, real GDP expanded 1.0 percent in 2012, decelerating from a 1.7-percent increase in 2011. Growth was mostly due to the output of services increasing 1.3 percent, led by wholesale trade, banking, lessors of real estate, health care, and architectural, engineering and related services. Real output in financial investment services, community colleges and CEGEPs, as well as federal government public administration services declined.

Gains in construction activity amounted to 4.4 percent, and were driven by engineering and non-residential building construction. Metal ore mining also increased, while support activities to mining industries declined. Manufacturing declined by 1.8 percent, with decreases in food products, clothing, pharmaceuticals, primary metal products and computer and electronic equipment.

In **Ontario**, real output rose 1.4 percent in 2012, slowing down from 1.8 percent in 2011. Manufacturing output increased 2.4 percent in 2012, the third consecutive year of growth. Export demand for automobiles led to a significant increase in motor vehicle and motor

vehicle parts manufacturing. Machinery and fabricated metal products manufacturing and pharmaceutical products manufacturing also advanced. Construction output increased 0.7 percent, with higher residential construction activity partly offset by declines in engineering and non-residential building construction. The services sectors reported 1.5-percent growth. Increases took place in banking, transportation, health care and professional, scientific and technical services. Federal government public administration and defence services declined.

In **Manitoba**, real output increased 2.7 percent in 2012, following a 1.8-percent gain in 2011. Crop production output recovered, growing 16.5 percent, due to better weather. Output in goods industries, with a growth of 5.2 percent, outpaced the service industries growth of 1.7 percent. A significant increase in oil and gas extraction more than offset a decline in metal ore mining. Construction rose 6.6 percent, with strong growth in residential and non-residential building construction. On the services side, transportation and wholesaling of petroleum products, machinery and equipment, and of building materials and supplies, banking, retail trade, and professional, scientific, and technical services all advanced.

In **Saskatchewan**, real GDP expanded 2.2 percent in 2012, slowing down from the 5.0-percent increase of 2011. Declines in non-metallic mineral mining (mainly potash) were more than offset by increased oil and gas production. Manufacturing output also grew briskly at 9.2 percent, with advances in machinery, wood products, chemicals and transportation equipment manufacturing. Construction of residential buildings and non-residential structures also grew, but was offset by a decline in engineering construction. Services output grew broadly, with increases in retail trade,

financial services, education, architectural and engineering services, and accommodation and food services.

In **Alberta**, real output grew 3.9 percent in 2012, down from the 5.3-percent mark in 2011. This was once again the strongest economic performance among Canada's provinces. Despite moderating energy prices, output in the oil and gas extraction industry increased 6.1 percent. However, support services to the oil and gas extraction industry fell by 17 percent. Manufacturing output grew by 5.3 percent on the strength of the growth in fabricated metal products, machinery, wood products and computer and electronic products. Wholesale trade and transportation services also advanced. Construction output rose 7.7 percent, with significant increases in oil and gas extraction, and electric power engineering construction. Strong demand for housing drove the 14-percent growth in residential construction. Services output increased 3.7 percent, with retail trade, professional, scientific and technical services, and business services all growing. Health care, education, and provincial and local public administration services also increased while the real output of defence and federal administration declined.

In **British Columbia**, real GDP increased 1.7 percent, following a 2.6-percent increase in 2011. Output in goods-producing industries rose 1.6 percent, driven by metal ore mining, construction, and manufacturing of wood products, fabricated metal products and transportation equipment. Significant declines took place in oil and gas extraction, paper products manufacturing and support activities for mining and oil and gas extraction. Construction activity increased 4.5 percent in 2012, with advances in residential and engineering construction. Services-producing industries grew

by 1.8 percent. Real output increased for wholesale and retail trade, transportation services, lessors of real estate, professional, scientific and technical services and health care services, while output for federal government public administration declined.

Output in the territories is typically more volatile than in the provinces due to their smaller populations and greater dependence on such activities as mining and exploration where GDP can vary considerably from year to year. In the **Northwest Territories**, real GDP increased 1.9 percent in 2012 following a 4.9-percent fall in 2011. A significant increase in output in mining and oil and gas extraction was responsible, despite the continuing decline in diamond mining. Engineering construction increased 33 percent, driven by increased construction activity at mine sites and a new bridge. Non-residential construction fell with the completion of a large school and a number of commercial projects. Services output increased by 0.5 percent, driven by increases in wholesale and retail trade, and finance and insurance services.

In **Nunavut**, real output expanded 4.3 percent in 2012, following a 4.8-percent gain in 2011. Mining and oil and gas extraction increased by 25 percent, followed by increased wholesale trade activity. However, construction activity declined 19 percent. Services output increased by 1.5 percent with increases in transportation, finance and insurance, education and government administration services.

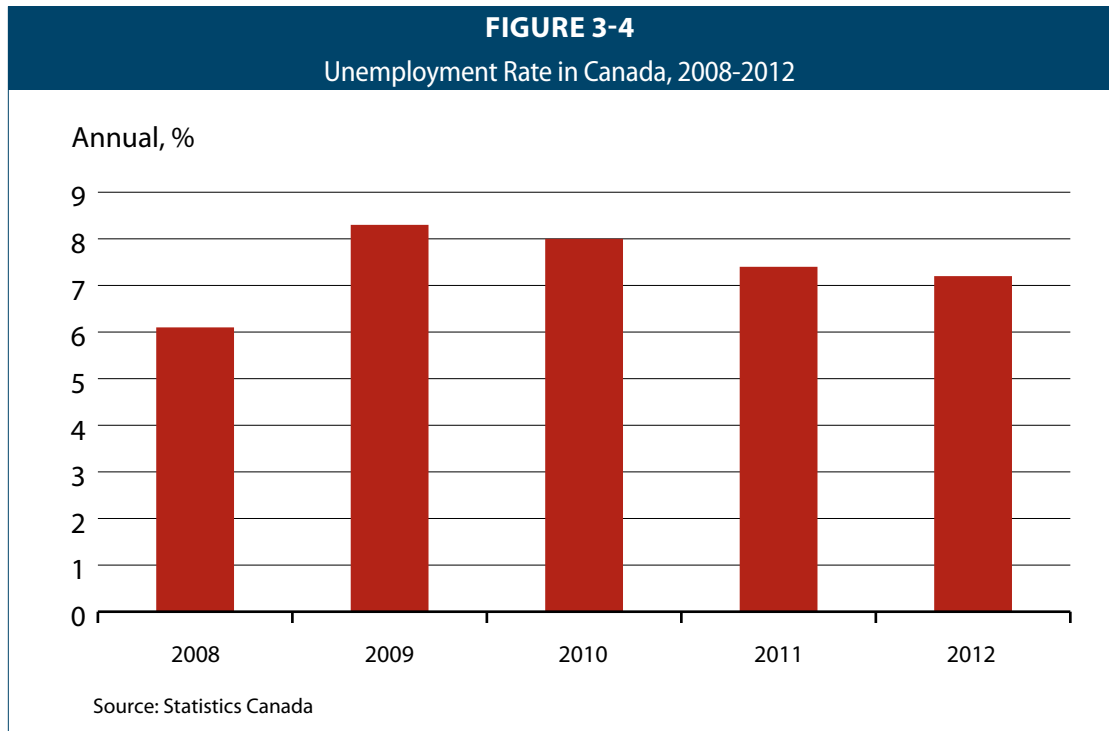
In **Yukon**, real GDP grew 3.4 percent in 2012 after a gain of 6.5 percent in 2011. Output of goods-producing industries drove the increase with a 6.1-percent growth. Mining output expanded by 21 percent, but was partially offset by a 24-percent decline in construction,

as a major electric power engineering project was completed. Output of services-producing industries increased 2.1 percent, with transportation and accommodation services as well as public sector services such as education, health care and government public administration services all contributing to the increase.

## Employment

2012 was another good year for employment in Canada, especially compared with the global situation. Recovery sped up during the year in comparison with the previous year, with employment increasing by 1.8 percent. During the year, 308,600 new full-time jobs were created, and 1,700 part-time jobs were lost, resulting in 310,300 net new jobs. From the start of the year to the end, the national unemployment rate decreased, going down by 0.4 percentage point from 7.5 percent in December 2011 to 7.1 percent in December 2012. The average unemployment rate for the year as a whole declined by 0.2 percentage point compared to 2011—from 7.5 percent to 7.3 percent (see Figure 3-4).

Gains in employment were distributed unevenly across the country. While two of the Atlantic provinces saw declines in jobs during the year—10,000 fewer jobs in Nova Scotia (down 2.2 percent, nearly reversing the gains of 2011), and 7,200 fewer jobs in New Brunswick (down 2.0 percent)—others did well. Newfoundland and Labrador led all the provinces with a 3.9-percent gain in employment (and 8,900 new jobs, almost two-thirds of which full-time) and Prince Edward Island gained 1.9 percent (and 1,400 new jobs, all part-time). By the end of December 2012, unemployment rates had declined from 13.1 percent in December 2011 to 11.6 percent in Newfoundland and Labrador, and from 11.3 percent to 11.0 percent



in Prince Edward Island. Unemployment grew in Nova Scotia (from 7.6 percent to 9.3 percent) and New Brunswick (from 9.9 percent to 10.8 percent).

Among the provinces, Quebec posted the most substantial overall gains with 135,400 new jobs—mostly full-time—over 40 percent of the grand total created across Canada. The unemployment rate stood at 7.3 percent in December 2012, down considerably from the 8.7-percent mark in December 2011.

Ontario created 102,800 new jobs, most of them full-time, which translated into a 1.5-percent increase in employment but left the unemployment rate slightly higher. Manitoba saw job gains of 12,100, or 1.9 percent, which decreased its unemployment rate to 5.2 percent at the end of 2012, compared with 5.0 percent at the end of 2011. Saskatchewan added 16,600 jobs, increasing its employment by 3.1 percent

and decreasing the unemployment rate from 5.2 percent at the end of 2011 to 4.6 percent at the end of 2012.

Further west, employment growth slowed down in Alberta to 1.5 percent during the year, translating into an increase of 32,400 jobs. In fact, 53,300 full-time jobs were created and 21,000 part-time jobs were lost during 2012, and the unemployment rate edged down to 4.5 percent by December 2012. British Columbia also generated 17,700 new jobs, a growth of only 0.8 percent, which nevertheless drove its unemployment rate down by 0.6 percentage point to 6.4 percent at the end of 2012.

Employment by industry shows a fairly even picture of job additions between the goods-producing industries (74,200 new jobs, an increase of 1.9 percent) and service-producing industries (236,100 new jobs, an increase of 1.7 percent). Utilities led the jobs gains in

the goods-producing sectors in 2012 (up 8.0 percent), but this translated to only 10,800 new jobs. More jobs were added overall in manufacturing (47,300, up 2.7 percent) and construction (8,800, up 0.7 percent), while employment in agriculture grew 3.0 percent (9,100 new jobs). 1,900 jobs were lost in the forestry, fishing, mining, quarrying, and oil and gas extraction industries (down 0.5 percent).

Employment increased in service-producing industries fairly evenly, with a few significant exceptions. Employment increased considerably in educational services (99,100 new jobs, an 8.1-percent growth) and the finance, insurance, real estate and leasing sector (64,500 new jobs, a 6.1-percent growth). Considerable growth was also observed in health care and social assistance employment, with 69,600 new jobs (up 3.3 percent). By contrast, employment in professional, scientific and technical services declined (down 70,800 jobs, or 5.2 percent). Job losses also took place in public administration, which reduced employment by 17,800 jobs, or 1.8 percent of the total.

At the end of the year 2012, employment stood at 17.7 million, well above its 17.2 million pre-recession high in October 2008, with over 310,000 new jobs created during the year and over a million since the Great Recession trough. Jobs growth stagnated after December 2012 for a few months due to harder economic conditions, but employment rebounded to 17.7 million in May.

Canada's participation rate remained at nearly the same level as in 2011, with the 2012 average

at 66.7 percent. The labour participation rate suffered a hit during the Great Recession that has yet to be corrected, although the decline was not nearly as pronounced as in the United States. The participation rate, on an annual basis, has steadily declined from 67.6 percent in 2008 to reach 66.7 percent in 2012.

## Inflation

Inflation was very mild in Canada in 2012. Consumer prices rose just 1.5 percent over the course of the year, following an increase of 2.9 percent in 2011, as reflected by the basket of goods and services used by Statistics Canada in the calculation of its Consumer Price Index (CPI). Inflation slowed down by almost half in 2012, largely due to the moderation in prices for gasoline and food items. This point is illustrated by the all-items CPI excluding food and energy, which declined by only 0.3 percentage point—from 1.6 percent in 2011 to 1.3 percent in 2012, while core inflation (according to the Bank of Canada definition<sup>1</sup>) actually increased—from 1.6 percent in 2011 to 1.7 percent in 2012.

The 2012 increase was well below the annual average growth rates in the CPI observed in the previous decade, and the lowest inflation figure since 1996. Nevertheless, prices rose in all eight major components of the CPI during the year, with food and transportation continuing to post the largest increases. However, the rate of inflation was lower than last year in seven of eight major components of the CPI. The inflation rate remained the same in household operations, furnishings and equipment.

1 The Bank of Canada's core index is a special aggregate of the CPI that excludes eight of its most volatile components (fruit, vegetables, gasoline, fuel oil, natural gas, mortgage interest, inter-city transportation and tobacco products) as well as the effect of changes in indirect taxes on the remaining components. It is used by the Bank of Canada as a policy instrument to help see through the temporary volatility in prices and maintain overall inflation within the 1 to 3 percent target range.



Food prices increased 2.4 percent during 2012, slowing down somewhat from the 3.7-percent growth in 2011. Prices for food purchased from stores declined more sharply (up 2.3 percent in 2012 as opposed to 4.2 percent in 2011), in spite of meat prices growing at the previous year's rate of 5.3 percent and fish and seafood prices growing at 2.6 percent in 2012, faster than 0.3 percent in 2011. The principal driver of the slowdown was the decline in vegetable prices of 3.2 percent in 2012, as opposed to the 7.1-percent increase in 2011. Other slowing prices included those of bakery and cereal products (up 3.0 percent in 2012 versus a 5.2-percent increase in 2011); dairy products and eggs (up 1.4 percent in 2012 versus a 2.9-percent increase in 2011); and other food products and non-alcoholic beverages (up 2.2 percent in 2012 versus a 3.3-percent increase in 2011). The growth in prices of food purchased from restaurants slowed down only slightly, from 2.8 percent in 2011 to 2.4 percent in 2012, with the greatest decline occurring in the prices of food purchased from fast-food and take-out restaurants.

Shelter costs rose 1.2 percent, slowing down from the 2011 figure of 1.9 percent. The costs of water, fuel and electricity moderated, growing only 1.2 percent, down from 4.0-percent growth in 2011. This in turn was driven by the 10.3-percent drop in the costs of natural gas, although water costs continued to climb (up 6.4 percent in 2012 and 5.8 percent in 2011). The costs associated with owner's accommodation grew more slowly in 2012 (up 1.2 percent) than the 1.4-percent increase in 2011, driven by cheaper mortgage rates and moderation in insurance prices; rented accommodation costs accelerated somewhat, from 1.1-percent growth in 2011 to 1.4 percent in 2012.

The costs associated with household operations, furnishings and equipment rose 1.9 percent in 2012, the same pace as in 2011. These costs were primarily kept in check by the continued decline in prices of household furnishings and equipment, which were down 0.6 percent—largely due to falling prices of furniture and textiles. This decrease in prices partly offset faster inflation in prices of communications and household cleaning products. Prices in the clothing, footwear and accessories sector increased marginally last year (up 0.1 percent), with prices of both clothing and footwear still declining; offsetting that decline, the costs of clothing accessories, watches and jewellery grew 4.7 percent and the costs of clothing materials and services grew 2.6 percent, which resulted in overall growth.

Transportation costs rose by a tame 2.0 percent, which was still high enough for a second-place ranking behind the food sector in terms of inflation. The soaring costs of gasoline (20.0-percent increase in 2011) came to a near-halt with only 2.5-percent growth in 2012. This reduced the growth in the costs of private transportation from 6.6 percent in 2011 to 1.9 percent in 2012. The costs of inter-city public transportation also fell from 7.7 percent in 2011 to 2.3 percent in 2012, although local and commuter public transportation grew at the same rate of 2.4 percent as in the previous year. Overall prices for public transportation thus grew 2.3 percent in 2012, down from the 5.6-percent pace of 2011.

Prices in the health and personal care sector advanced 1.4 percent in 2012, down from the 1.7-percent increase during 2011. Health care goods became cheaper by 1.0 percent, but the



increases in prices of health care and personal care services (2.4 percent and 2.1 percent, respectively) offset that decline.

Prices in the recreation, education and reading sector increased 0.6 percent last year, down from the 1.3-percent mark in 2011. Prices for goods associated with this category generally fell—home entertainment equipment prices by 8.2 percent, and recreational equipment and services prices by 3.5 percent; however, these were more than offset by the rising prices of education (including tuition fees), various cultural and recreational services and travel services.

Finally, prices for alcoholic beverages and tobacco products rose 1.5 percent in 2012, down from the 1.9-percent increase in 2011. Prices of tobacco products moderated considerably (1.3-percent growth in 2012 versus 3.7-percent growth in 2011), but the prices of alcoholic beverages increased faster than in the previous year (1.5-percent growth in 2012 versus 0.3-percent growth in 2011).

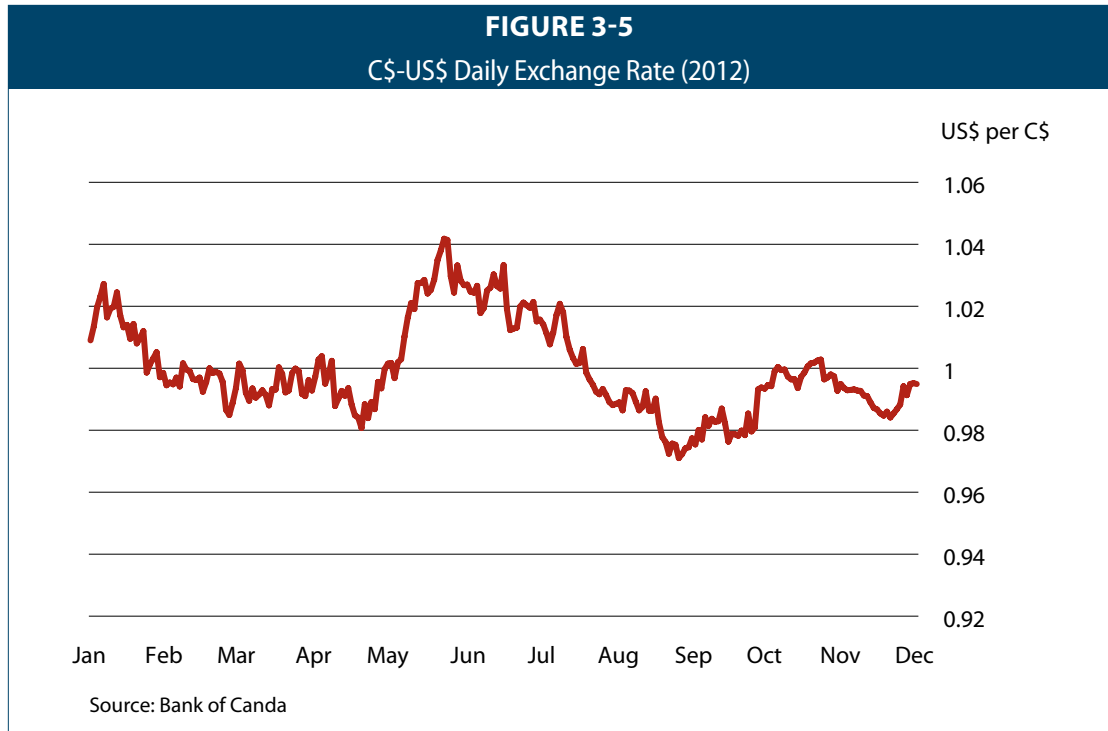
By province, inflation was fairly even across the country. Whitehorse in the Yukon and Yellowknife in the Northwest Territories showed the highest rates, at 2.3 percent and 2.2 percent, respectively. In the Atlantic provinces, Newfoundland and Labrador was in the lead with 2.1 percent, Nova Scotia and Prince Edward Island each posted 2.0 percent inflation and New Brunswick experienced 1.7 percent inflation. Prices rose 2.1 percent during the year in Quebec, but only 1.4 percent in Ontario. Manitoba and Saskatchewan both observed a 1.6-percent growth in prices, and,

finally, Alberta and British Columbia each posted the lowest inflation rate in the country—1.1 percent.

## The Canadian dollar

The appreciation of the Canadian dollar against the U.S. dollar stopped in 2012. After gaining 10.9 percent against the U.S. dollar in 2010 and 4.1 percent in 2011, the Canadian dollar declined in value by 1.1 percent in 2012 relative to the greenback. The 251-day average valuation of the Canadian dollar was almost exactly at parity with the U.S. dollar in 2012 at US\$1.00042—a one U.S. cent-decline over the year. Relative to the other major currencies, the average yearly value of the Canadian dollar rose 7.1 percent against the euro and 0.1 percent against the British pound sterling, but declined 1.0 percent against the Japanese yen.

Yearly dynamics of the Canadian dollar against the U.S. dollar were relatively smooth in 2012 (see Figure 3-5). All the highs and lows that occurred during the year were restricted to a 7-cent band (from US\$0.97 to US\$1.04), which was slightly more than half the width of the 12-cent band in 2011. On January 3, 2012, the Canadian dollar was at near-parity with the U.S. dollar (US\$1.009), and quickly climbed to a local high of US\$1.027 by January 9. This was quickly reversed by a return to parity at the end of January, and a long period of stability around parity. Another small decline took place in the second half of April, with the Canadian dollar declining to US\$0.981 by April 27, but then a quick rise took it to its high for the year of US\$1.042 by early June. From there, the Canadian dollar gradually declined to parity in early August, and then to its low



for the year of US\$0.971 on September 14. By late October, the Canadian dollar was back to parity, and after another small dip in December

it closed the year just as it began, at near-parity (US\$0.995 on December 31, the final trading day of the year).<sup>2</sup> ■

<sup>2</sup> Bank of Canada daily noon exchange rate statistics at <http://www.bankofcanada.ca/rates/exchange/10-year-lookup/>.

## The Economic Impact of the Canada-Chile Free Trade Agreement

2012 marked the 15th anniversary of the implementation of the Canada-Chile Free Trade Agreement (CCFTA). This anniversary offers both an occasion, and a retrospective, to assess what the Agreement has achieved, and to determine to what extent the Agreement has delivered on its potential. As demonstrated by a recent study carried out by the Office of the Chief Economist,<sup>1</sup> the Agreement has been a great success. Both Canada and Chile were able to expand their bilateral trade flows, reap benefits beyond those induced by tariff reductions and generate significant income gains. The study finds that trade between Canada and Chile grew 12 percent faster annually than would have been the case in the absence of the CCFTA. In addition, the Agreement made an annual contribution of a quarter of a billion dollars (or \$250 million) to the incomes of Canadians.

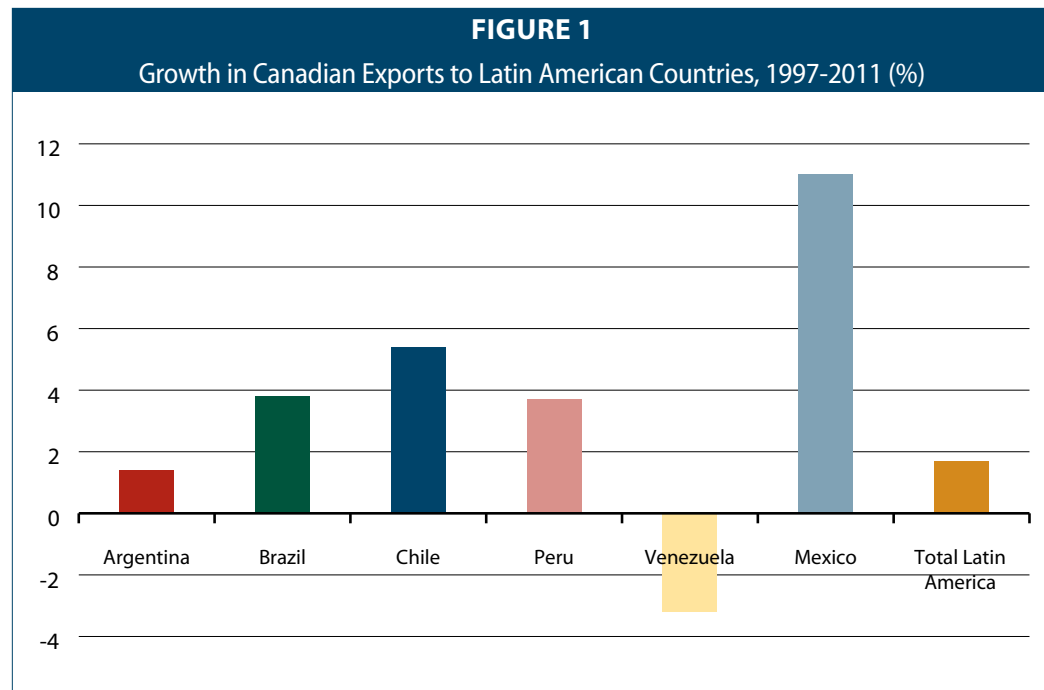
### Increased Trade

Bilateral merchandise trade between Canada and Chile grew impressively over the 15 years since the implementation of the CCFTA. Canadian exports to Chile more than doubled, increasing from \$392 million in 1997 to \$819 million in 2011—an annual average growth rate of 5.4 percent. Canadian imports from Chile grew six fold to reach \$1.9 billion in 2011 from only \$326 million in 1997—an annual average growth rate of 13.5 percent. However, nearly 50 percent of Canada's imports from Chile in 2011 were gold, which was not targeted by the CCFTA. Nevertheless, even with gold excluded, Canada's imports from Chile still amounted to \$1 billion, tripling the level in 1997.

The impact of the CCFTA is even more apparent when the growth in Canada-Chile trade is compared to Canada's trade with other South American countries. Between 1997 and 2011, Canadian exports to the Latin American region grew only 1.7 percent yearly on average, and imports from the region grew by 3.1 percent. As a result of the much faster growth in Canada-Chile trade over this period, Chile rose to become Canada's third most-important trading partner in the region in 2011 from seventh place in 1997.

Bilateral trade flows can be impacted by a number of factors other than trade agreements, such as general economic performance, currency movements and sector-specific developments, among others. Thus, in order to evaluate the effect of the CCFTA on trade, it is necessary to remove any obscuring effects through econometric analysis. This analysis reveals that, on average, trade between Canada and Chile grew 12 percent faster annually than it would have without the Agreement. This effect is the “all-in” effect of the CCFTA, which captures both

<sup>1</sup> [http://international.gc.ca/wet30-8/analysis-analyse/studies-etudes/canada\\_chile-canada\\_chili/econo\\_impact\\_toc-tdm.aspx?lang=eng](http://international.gc.ca/wet30-8/analysis-analyse/studies-etudes/canada_chile-canada_chili/econo_impact_toc-tdm.aspx?lang=eng)



tariff- and non-tariff effects. The result is in line with the understanding that a free trade agreement often influences trade beyond such a traditional vehicle as tariff reduction. It also suggests that measures to liberalize investment and services, which are common in today's new generation of free trade agreements, along with the added certainty following the trade deal, could have a significant effect on two-way trade in goods over and beyond the effect induced by lower tariffs.

### Gains in New Trade

The CCFTA not only helped to increase the trade between Canada and Chile, it also helped to expand the variety of products traded. In 2011, more than 900 new product varieties were imported from Chile that were not imported in 1996, and more than 1,000 new product varieties were exported to Chile that were not exported in 1996. This is consistent with the notion that preferential trade agreements lead to both an expansion in trade flows as well as the creation of new trade. It is notable that in the case of the CCFTA, the expansion of trade was dominated by its effect on product scope more than its effect on trade volume. New product varieties accounted for almost 57 percent of bilateral trade between Canada and Chile in 2011, and approximately 79 percent of the net increase in trade was in new product varieties.

A similar approach can be used to analyze the trade-creating effects of the CCFTA by decomposing trade into two parts: the increase in trade volume of each product (intensive margin) and that contributed by the increase in the number of products (extensive margin). For Canada's imports from Chile, both intensive and extensive margins increased significantly

**TABLE 1**  
Changes in Products Traded with Chile, 1996 and 2011

		In 1996	In 2011		
			Existing Products	New Products	Total
<b>Imports from Chile</b>	Number of products	454	288	922	1,210
	Value (billion \$)	0.34	0.72	1.19	1.91
<b>Exports to Chile</b>	Number of products	848	581	1,178	1,759
	Value (billion \$)	0.42	0.46	0.36	0.82

following the implementation of the CCFTA. On the other hand, for Canada's exports to Chile, the extensive margin was much greater than the intensive margin. This suggests that, as might have been expected, the CCFTA was successful in lowering the entry threshold into the Chilean market for Canadian exporters. For existing products, however, there was a decline in the trade volume. This may be due to an increase in competition that resulted from the large number of trade agreements that Chile subsequently signed with third countries.

A complementary study commissioned to examine how Canadian exporters adjusted to the CCFTA using a different data set (i.e. the firm-level data) also reports very similar results.<sup>2</sup> The study found that the intensive margin associated with the older products drove Canadian export growth to Chile in the early years of the Agreement. However, over a longer horizon after the implementation of the CCFTA, the contribution of new firms with new products increased almost exponentially. As a result, the new firms and the new products shaped the long-run effect of the CCFTA, while the old firms and old products drove the short-run effect of the CCFTA.

## Economic Welfare

Free trade agreements are important not only for their impact on trade but also for their positive impacts on the incomes of Canadians as a result of lower prices and a better allocation of resources domestically. This is indeed what was found to be the case for the CCFTA, which is estimated to have made an annual contribution of \$250 million to the incomes of Canadians. ■

<sup>2</sup> Voia, Marcel and Youssef Budribila (2013). "Measuring the Impact of CCFTA on Canadian Exports to Chile through Product Diversification, New Entry, and Margin of Trade." Memo.

## A Summary of the Historical Revisions to Canada's System of National Economic Accounts

Statistics Canada conducts regular revisions to the Canadian System of National Economic Accounts (CSNEA) in order to incorporate the most current information on the economy from censuses and annual surveys and to improve estimation methods. These revisions are limited to a few years. However, periodically, the National Accounts undergo historical revisions, which are much broader in scope, encompass a longer time frame, and involve conceptual, classification, presentational, and major statistical changes. In October 2012, Statistics Canada introduced historical revisions to the CSNEA. The revisions go back to 1981, with revisions back to 1947 on a quarterly basis and to 1926 on an annual basis planned for a later date. This box summarizes some of the key changes that have been made to the National Accounts.

### Why an historical revision of the CSNEA?

The revised data are the result of a project to more closely align the Canadian system with new international standards released in 2009 by international bodies, including the World Bank and the International Monetary Fund. These revisions help maintain the accuracy and relevance of the Canadian economic accounts. They ensure that Canadian economic data are internationally comparable and are compiled using the latest methodological advances. Other countries are also in the process of updating their economic accounts to the new international standard. For example, the United States will release its changes based on the new standards in July 2013.

For Canada, the move to the new standard also gave rise to an opportunity to integrate updated source data and statistical techniques. The moves add further detail to existing economic estimates and reflect the changing nature of the Canadian economy. For example, the new approach now measures income flows for more sectors of the economy, which helps to better understand how income is used for consumption or saving, and how it is re-routed to other sectors through the borrowing and lending process. To this end, the CSNEA now cover five resident sectors (non-financial corporations; financial corporations; government; non-profit institutions serving households; and households), up from three (persons and unincorporated businesses; corporations, and government) previously.

### Revisions to gross domestic product

A number of measures have been introduced to the new CSNEA that affect the measure of gross domestic product (GDP). The changes, all totalled, do not result in a substantial change to the level, nominal growth rate, or real growth rate of GDP.

The major changes impacting the measure of GDP are as follows:

- Reclassify expenditures by businesses and government on research and development (R & D) as investment (gross fixed capital formation). Previously, expenditures on R & D were treated as intermediate expenditures by businesses and as final consumption expenditures for government.
- Reclassify military weapons systems from final consumption expenditures to government investment.
- Switch the method of depreciation used on government consumption of fixed capital from a linear method to a geometric method.

The major change to income-based GDP has been a change in its presentation. The old presentation of income-based GDP was a mix of national accounting concepts (labour income, taxes less subsidies) and business accounting concepts (corporate profits, net income of unincorporated businesses) with adjustments to bring it in line with national accounting practices (inventory valuation adjustments, miscellaneous investment income). To better align the Canadian presentation with the international standard, the income-based GDP measure now comprises the sum of compensation of employees (or returns to labour used in the production of goods and services) plus gross operating surplus (or returns to capital used in the production of goods and services) plus gross mixed income (or returns to labour and capital used in the production of goods and services when they cannot be separately identified, as in the case of unincorporated businesses) plus taxes less subsidies.

## What is Canada's System of National Economic Accounts?

The Canadian System of National Economic Accounts (CSNEA) is a comprehensive set of statistical statements, or accounts, each one providing an aggregated portrait of economic activity during a given period. Each account differentiates itself from the others by providing a different perspective of the economy. However, as these accounts all use a common set of definitions, concepts, and classifications, and are explicitly related to each other, they form an integrated system. When taken together, the CSNEA give a complete overall view of changes taking place in the economy; they also provide a comprehensive basis for economic analysis. In addition, beyond describing the national economy, the provincial and territorial dimension also forms part of the CSNEA.

The system consists of a number of different statistical reports, in particular: **1) the income and expenditure accounts**, which show all the different sources of income (such as wages and salaries, corporate profits, transfers, and dividend and other investment



income) along with all the various forms of spending in the economy (such as consumer spending, government expenditures, business investments, and exports and imports); **2) the balance of international payments**, which focuses on our country's economic relations with the rest of the world; in particular, our trade, investment, travel, and other transactions with non-residents; **3) the input-output accounts**, which show the production of an industry or the economy by commodity (covering goods and services), and itemizes the raw materials, parts, components, and services that production requires from other industries. These accounts provide the detailed structural picture of the economy, covering more than 700 commodities and 300 industries.; and **4) the financial and wealth accounts**, which are made up of the financial flow accounts and the national balance sheet account. The financial flow accounts show the lending, borrowing, and investment for each sector by type of financial asset (shares, bonds, loans, etc.), while the national balance sheet accounts (NBSA) present, for each sector, the value of physical and financial assets, the value of financial liabilities, and the net worth at the end of each period.

On the expenditure-based approach to measuring GDP, the expansion of institutional units under the revised approach allows for greater separation of expenditures. As a consequence, transactions of non-profit institutions serving households and Aboriginal general governments have been delineated from the expenditures of households and recorded in their own sectors. The result is a large downward revision to the level of household final consumption expenditures, of some \$32.3 billion in 2011. In addition, a number of methodological improvements were made to selected household expenditures that raised expenditure estimates, but not enough to offset the reductions brought about by separating out non-profit institutions serving households and Aboriginal general government expenditures from household expenditures.

The net effect of these modifications was a slight upward shift in the level of GDP over the period of revision. In 2011, the last full year to compare the new and old estimates, the nominal level of GDP was raised by nearly \$41.7 billion because of the revisions. This is not a relatively substantial amount in comparison to the \$1.8-trillion size of the economy. As a consequence, the upward revision had little impact on the growth of nominal GDP, averaging 0.15 percentage point in absolute terms to the annual nominal growth rate in GDP. Similarly, the revisions had little impact on the growth of real GDP, averaging 0.14 percentage point in absolute terms to the annual real growth rate.

However, of particular interest are the real rates of growth during business cycles characterized by a recession and a recovery period. The historical revision did little to change the depth or length of the economic contractions that occurred in 1982 and 1991, but show that

the 2008-2009 economic downturn was both larger and steeper than previously thought: the declines in the fourth quarter of 2008 and first quarter of 2009 were more pronounced than previously estimated.

Also of note, the net downward changes to household final consumption combined (resulting from the removal of transactions of non-profit institutions serving households and Aboriginal general governments from the expenditures of households) with the upward revision to overall GDP have reduced the share of household expenditures in GDP. However, these changes have left the underlying growth rates for household final consumption expenditure substantially unchanged from their previous estimates under the former CSNEA.

### Revisions to the current and capital accounts

The major change associated with this revision also relates to the addition of new sectors: non-profit institutions serving households; non-financial corporations; financial corporations; and Aboriginal general governments. In the previous vintage of the Canadian economic accounts, the household sector included the activities of non-profit institutions serving households, Aboriginal general governments, and some financial corporations. In the revised approach, the sector only includes households and therefore more accurately reflects the incomes and expenditures of households. In addition, the definition of household disposable income is now aligned with the international standard in that transactions such as interest on consumer credit are removed before estimating disposable income.

As a result of these changes, household expenditures were lowered with the redefinition of the sector, moving from 56 percent of GDP to 53 percent in 2007 under the new approach. The level of household saving was also lowered; however, the household saving rate exhibits the same trend as before—a gradual decline from 1981 to 2005 and a slight upward trend since 2005. Similarly, household disposable income in 2007 was lowered by roughly 5 percent compared with its previous reported value.

### Revisions to the international accounts

A number of revisions to the current account components have tended to revise up the overall current account deficits and revise down surpluses by small amounts for most years since 1981. The restructuring of the current account to include cross-border compensation of employees was one such revision that resulted in increased payments relative to receipts. Also, investment income payments on portfolio investment were revised up for a number of more recent years, reflecting an upward revision to foreign holdings of Canadian equity securities.

In the balance of international payments (BOP), revisions did not materially change the current account balance over time. For trade in goods and services, there were a number of statistical revisions, as well as conceptual changes to the estimates. For example, repairs were

reclassified from trade in goods to trade in services, following international standards. Also, international trade in patents is now included under commercial services, trade in insurance services is now reported on a net basis (whereas they were previously reported on a gross basis), and financial intermediation services indirectly measured has been reclassified from its own commodity group to commercial services. As well, a number of other statistical revisions were also incorporated, most of which centred on removing several transactions involving military goods that were moved from Canada to other countries for military operations. However, the major statistical change was the upward revision to estimates in trade in services from improvements to the survey methodology and size, along with better linkages to other data sources. As a result, both exports and imports of services were revised up, with exports generally revised up more than imports. The overall impact of these changes is that Canada has been running a commercial services trade surplus for longer than previously thought, while the overall services trade deficit has been less than previously thought.

In the capital account and in the financial account of the BOP, statistical revisions from 1981 were minimal in terms of the balance.

The elimination of migrants' funds from transactions, as per the international standard, altered the totals in both the capital and financial accounts. Portfolio transactions were revised from 1999 forward, and there were some reclassifications of transactions across financial account categories that resulted in a closer link to the assets and liabilities of the international investment position.

Similarly, in the international investment position, statistical revisions were moderate over the period of revision. At book value, Canada's net foreign debt was largely unchanged, except in more recent years (mainly, 1999 forward). In these years, government international loan assets were revised to reflect a more accurate recording of loan allowances and there was a large upward revision to foreign holdings of Canadian equity securities.

Market valuation of relevant international assets and liabilities has been introduced from the first quarter of 1990 and becomes the official valuation of Canada's international investment position. This new measure of Canada's net foreign debt differs from the previous book value measure in earlier periods as the revaluation of assets was relatively larger than that for liabilities. In recent periods, the differences between the market and book value measures of net foreign debt have been relatively small. This means that aggregate inward and outward foreign direct investment (FDI) statistics are now available at their end-of-period market valuations, although direct investment levels by country are still only available on their book value measurements. ■

# Overview of Canada's Trade Performance

After two consecutive years of strong recovery, Canada's trade in goods and services slowed down somewhat in 2012. Imports put in a stronger performance, relying on strong domestic demand, while exports grew more slowly, hampered by the slower global growth. Exports and imports expanded in a slim majority of sectors. The share of trade with the United States expanded for the first time in 14 years.

Export growth was led by exports to the United States, reversing the trend of the decline of the share of the United States as a destination for Canada's exports. The automotive and agri-food sectors led the increase in exports, with exports of energy products continuing to expand as well, especially in volumes. Improvements in previously declining exports from the automotive and forestry sectors have now continued for three consecutive years. Goods export prices fell by 0.9 percent during 2012.

Imports climbed faster than exports, as the domestic economy remains relatively stronger than the economies of its trading partners, despite being buffeted by external shocks. Leading the expansion were imports from the United States, which reversed its long-retreating market share as a supplier of Canada's imports. By sector, automotive products, consumer goods and machinery imports led the expansion. Goods import prices increased 0.7 percent in 2012.

Since exports grew more slowly than imports last year, the trade balance deteriorated, which added \$14.4 billion to Canada's trade deficit. A deficit was recorded in goods, which had previously registered a small surplus in 2011 after two years of deficits; most of this deterioration can be traced to the decline or stagnation in energy prices. The deficit in exports of services widened somewhat as well. As a result, Canada's current account deficit widened accordingly, from \$48.5 billion to \$62.2 billion.

## Goods and Services

Canada's international trade continued to recover in 2012, though at a reduced pace of 2.4 percent. Nevertheless, this was enough to exceed the 2008 level and set a new record high: \$1.13 trillion worth of goods and services were traded. Canada's total exports of goods and services increased in value by 1.1 percent in 2012. This amounted to a \$6.0-billion increase in exports to \$546.6 billion (Table 4-1). Meanwhile, imports of goods and services grew more significantly, at 3.6 percent, or \$20.3 billion, to reach \$582.8 billion—a record-high value. These movements widened the trade deficit by \$14.4 billion (from \$21.9 billion in 2011 to \$36.2 billion in 2012), which originated with the 2009 meltdown in world trade.

Among the major market areas in 2011, trade in goods and services with the United States experienced the most steady improvement,

<b>TABLE 4-1</b>							
<b>Canada Goods and Services Trade by Region, 2012</b>							
<b>(\$ millions and annual % change)</b>							
	Exports of Goods and Services			Imports of Goods and Services			G&S Balance
	2012	2012 share	% growth over 2011	2012	2012 share	% growth over 2011	2012
<b>World</b>	<b>546,614</b>	<b>100.0%</b>	<b>1.1%</b>	<b>582,835</b>	<b>100.0%</b>	<b>3.6%</b>	<b>-36,221</b>
U.S.	384,028	70.3%	2.2%	358,444	61.5%	4.8%	25,584
EU	55,254	10.1%	-3.7%	61,935	10.6%	-3.1%	-6,679
Japan	12,080	2.2%	-4.2%	12,368	2.1%	13.9%	-289
ROW	95,252	17.4%	0.4%	150,088	25.8%	3.0%	-54,837
	Exports of Goods			Imports of Goods			Goods Balance
	2012	2012 share	% growth over 2011	2012	2012 share	% growth over 2011	2012
<b>World</b>	<b>462,528</b>	<b>100.0%</b>	<b>1.3%</b>	<b>474,544</b>	<b>100.0%</b>	<b>4.1%</b>	<b>-12,016</b>
U.S.	338,440	73.2%	2.6%	296,458	62.5%	5.3%	41,982
EU	40,972	8.9%	-3.4%	44,613	9.4%	-2.6%	-3,640
Japan	10,824	2.3%	-4.5%	10,792	2.3%	15.2%	32
ROW	72,292	15.6%	-1.1%	122,681	25.9%	2.7%	-50,390
	Exports of Services			Imports of Services			Services Balance
	2012	2012 share	% growth over 2011	2012	2012 share	% growth over 2011	2012
<b>World</b>	<b>84,086</b>	<b>100.0%</b>	<b>0.3%</b>	<b>108,291</b>	<b>100.0%</b>	<b>1.7%</b>	<b>-24,205</b>
U.S.	45,558	54.2%	-0.6%	61,986	57.2%	2.4%	-16,398
EU	14,282	17.0%	-4.6%	17,321	16.0%	-4.3%	-3,039
Japan	1,256	1.5%	-1.5%	1,577	1.5%	5.8%	-321
ROW	22,960	27.3%	5.6%	27,407	25.3%	4.1%	-4,447

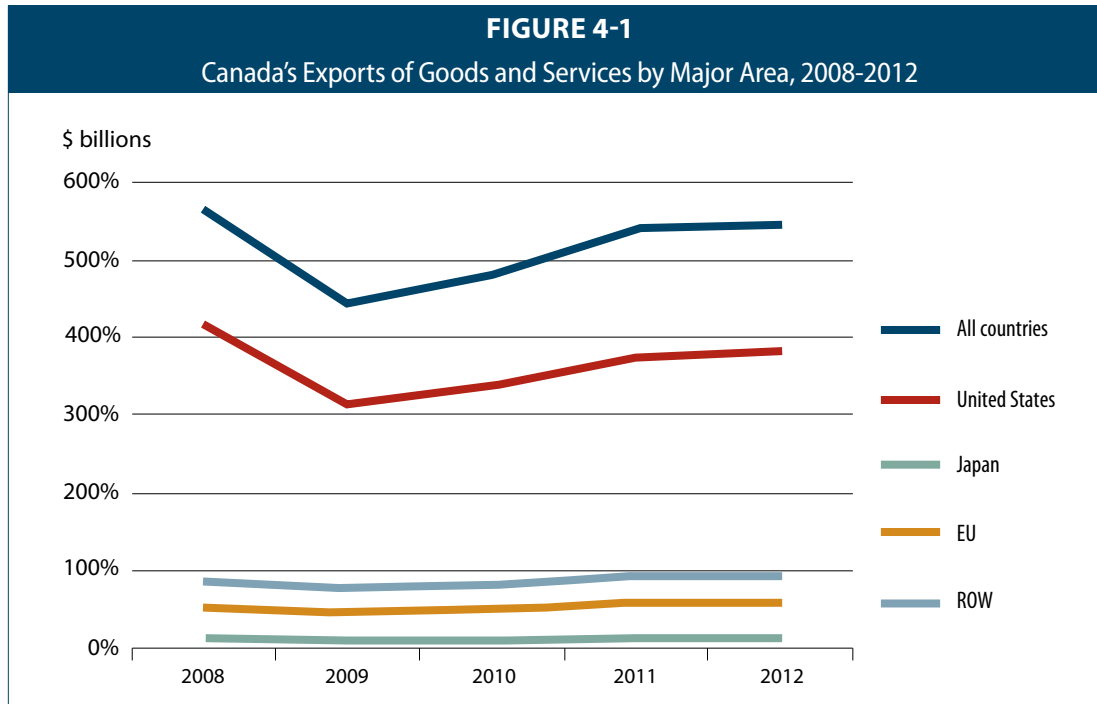
ROW = Rest of World

Source: Statistics Canada, CANSIM Table 376-0101

with the U.S. share of Canada's overall trade growing from 65.1 percent in 2011 to 65.7 percent in 2012. This interrupted a downward trend dating back to 1999, when the U.S. share stood at 77.8 percent.

Growth in exports of goods and services to the United States was the strongest among all

major destinations at 2.2 percent, or \$8.2 billion. The total value of the U.S. share reached \$384.0 billion, or 70.3 percent of Canada's total exports of goods and services. This was up from 69.5 percent in 2011, the first increase in the U.S. share since 2005. Exports to all other major destinations stagnated or declined: down 3.7 percent to the EU, down 4.2 percent

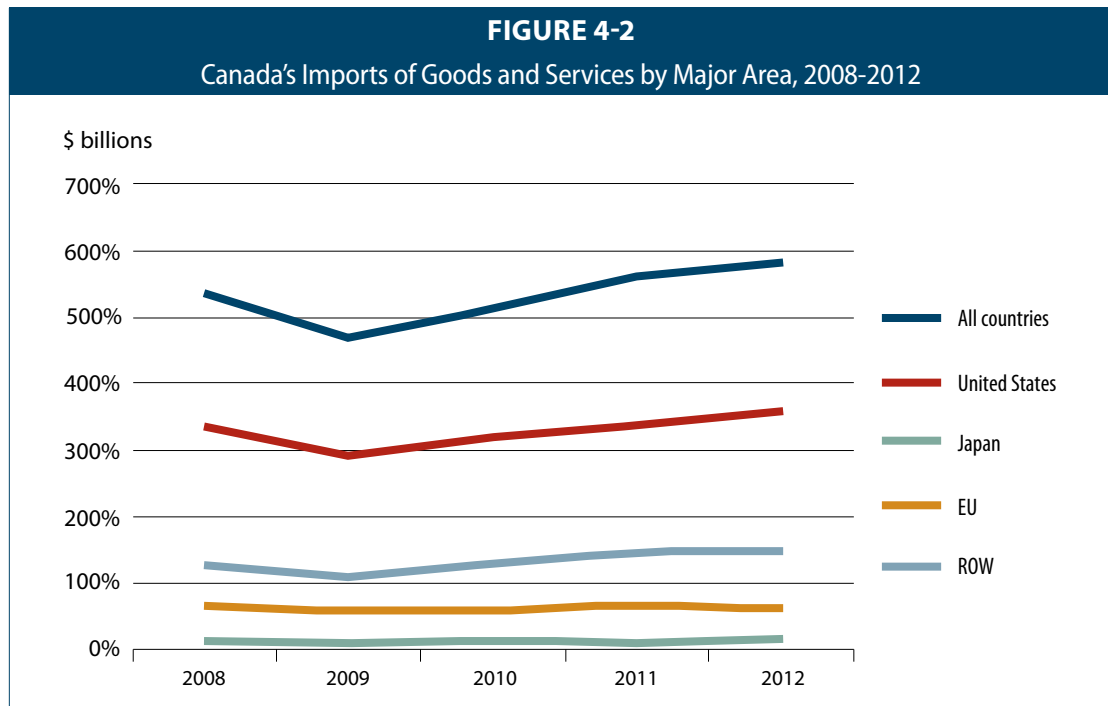


to Japan and marginally up (0.4 percent) to the rest of the world (ROW), which includes all of the OECD countries (with the exception of the United States, the EU and Japan) and all of the non-OECD countries combined. Accordingly, the shares of all other export destinations relative to the United States declined somewhat. Exports of goods and services to the EU fell by \$2.1 billion, and exports to Japan fell by \$0.5 billion. Exports to the ROW added just \$0.4 billion, to reach a total of \$95.3 billion last year.

Imports of goods and services from most major areas showed stronger growth, with the exception of the EU. In 2012, Canada imported 4.8 percent, or \$16.4 billion, more goods and services from the United States than in the previous year. While slower than in 2011, this growth was sufficient to reverse the sliding market share of the United States as a supplier of Canada's imports, a trend dating back to 1998 when the U.S. share was 74.8 percent. In 2012, the United States was the source of 61.5 percent

of Canada's imports of goods and services, up from 60.8 percent in 2011; this amounted to \$358.4 billion, a record high. Imports from Japan increased by a strong 13.9 percent, or \$1.5 billion, as Japan's economy recovered from the disasters of 2011. While Japan's share climbed back up to 2.1 percent, Japan's overall role as an import supplier has been much reduced from the 6.1-percent level of 1986. Imports from the EU declined 3.1 percent, or \$2.0 billion, to \$61.9 billion overall. This was caused by the decline in imports from the United Kingdom (down \$2.3 billion). The value of imports of goods and services from the ROW into Canada grew by \$4.3 billion last year, up 3.0 percent, to reach \$150.1 billion. Nevertheless, the ROW share of Canada's total imports declined to 25.8 percent, the first recorded decline since 1998.

The \$14.4-billion increase in the trade deficit was broad-based, as exports either declined, or grew more slowly than imports. The trade surplus with the United States fell from \$33.8



billion in 2011 to \$25.6 billion in 2012, adding \$8.2 billion to the deficit. An improvement in the trade balance with the United Kingdom was offset by a deteriorating balance with the rest of the EU, for a combined increase of \$0.2 billion in the trade deficit with the EU. The deficit widened by \$2.0 billion with Japan and by \$4.0 billion with the ROW. The latter deficit reached \$54.8 billion in 2012, another record high.

### Goods Trade

Goods remain the dominant component of Canada's total trade, although services account for a much greater part of the domestic economy. The share of goods in total exports stood at 84.5 percent in 2012, unchanged from 2011. While this share has declined somewhat from a high of 89.7 percent in 1984, this decline has been slow and irregular, with occasional increases along the way. Goods will remain the dominant component of Canada's trade in the foreseeable future.

The total value of goods exports rose by 1.3 percent last year, or \$5.7 billion, to reach \$462.5 billion. This increase accounted for 96.1 percent of the total growth in exports. Overall trade increased by \$26.2 billion, with goods responsible for 92.2 percent of that increase. Total goods trade reached a new record high—\$937.1 billion—exceeding the 2008 level of \$930.9 billion. Goods imports rose 4.1 percent in 2012, an increase of \$18.5 billion. This increase in imports reversed the short-lived \$0.7-billion goods surplus of 2011: a record-high goods deficit of \$12.0 billion was recorded in 2012.

The increase in goods exports to the **United States** amounted to \$8.5 billion, more than the total increase in exports to all destinations for the year. Goods imports from the United States accounted for 81.1 percent, or \$15.0 billion, of the total growth in goods imports in 2012. As growth in imports from the United States was faster than growth in exports to the United States, the goods trade surplus with Canada's



biggest trading partner decreased by \$6.5 billion (just over half of the total \$12.8-billion deterioration in the goods trade balance) to reach \$42.0 billion last year.

Canada's goods exports to the **EU** fell by \$1.4 billion in 2012, down 3.4 percent. Imports declined as well, due to the drop in imports from the United Kingdom. Goods imports from the EU now stand at \$44.6 billion, down 2.6 percent on the year and under 10 percent of all Canada's goods imports. These reductions left the overall goods deficit with the EU little affected, at \$3.6 billion—a widening of \$0.3 billion—as a significant improvement in the goods surplus with the United Kingdom almost entirely offset the widening of the deficit with the rest of the EU.

Goods exports to **Japan** fell by 4.5 percent in 2012, losing \$0.5 billion in value to end at \$10.8 billion for the year. However, a large 15.2-percent increase in goods imports from Japan added \$1.4 billion, bringing the value of imports to \$10.8 billion for the year. These movements erased the \$2.0-billion goods surplus with Japan recorded in 2011: in 2012, the trade balance in goods with Japan was \$0.03 billion.

A 1.1-percent reduction (\$0.8 billion) occurred in goods exports to the rest of the world (ROW). By contrast, goods imports grew by 2.7 percent, gaining \$3.2 billion to reach \$122.7 billion in 2012. Therefore, Canada's trade deficit in goods with the ROW continued to widen, increasing by \$4.0 billion to reach \$50.4 billion.

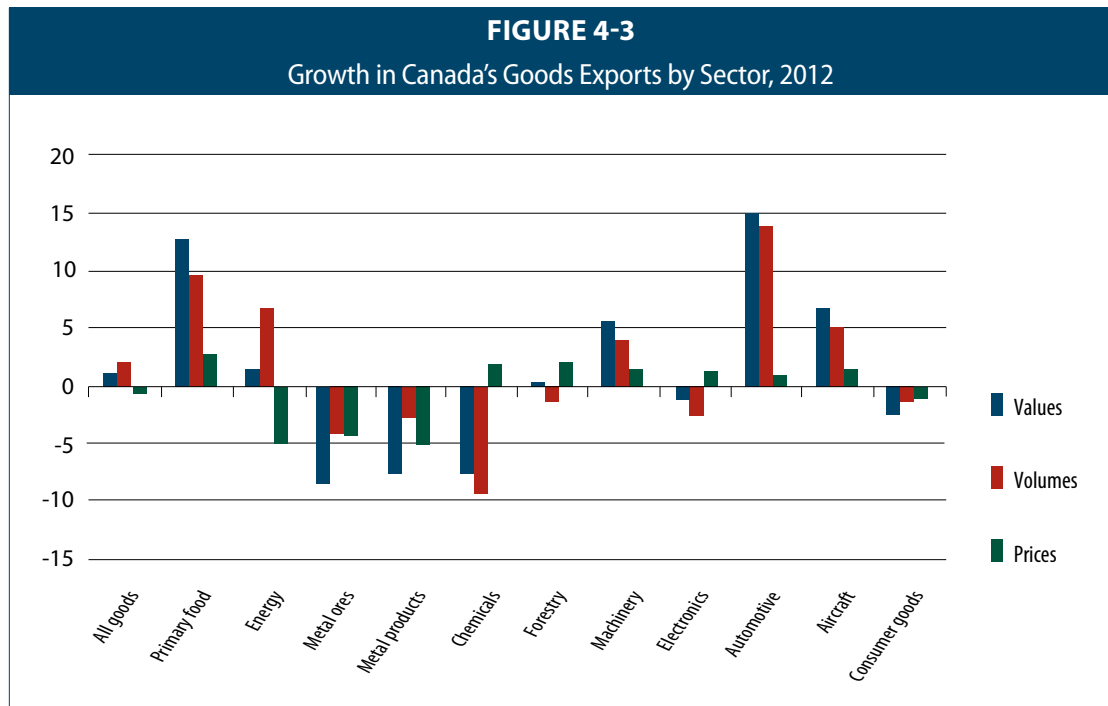
## Sectoral Performance of Goods Trade

Several developments at the sector level led to slow growth in the goods trade in 2012. Increases and declines were spread fairly evenly among the major sectors, with exports rising in six sectors and declining in five.<sup>1</sup> While the observed 1.3-percent growth in the value of goods exports in 2012 was one tenth as large as the 13.1-percent growth in 2011, the growth in volumes was much more comparable. In constant dollar terms, goods exports increased 2.1 percent in 2012 compared with a 5.0-percent increase in 2011. Most of the perceived slowdown in the exports of goods was due to prices, which fell 0.9 percent in 2012.

The **energy** products sector was the biggest exporter in 2012, with exports of \$105.1 billion. This was an increase of only \$1.6 billion, or 1.5 percent, over 2011 but in constant dollar terms, much higher growth (up 6.9 percent) took place to offset a 5.0-percent decline in prices. By sub-sector, nominal exports rose for crude oil (up 6.9 percent, or \$4.7 billion) and especially for refined oil products (up 35.1 percent, or \$3.7 billion). This growth was partially offset by a decline in natural gas exports (down 31.9 percent, or \$4.7 billion). Exports of other energy products (including coal) also fell (down 24.2 percent, or \$1.7 billion), while exports of electricity edged down 5.1 percent, or \$0.1 billion.

With exports of \$68.5 billion in 2012, **motor vehicles and parts** was the second-largest goods exports sector and experienced the most growth. The automotive sector underwent its

<sup>1</sup> In 2012, Statistics Canada introduced the North American Product Classification System, a new classification structure for reporting imports and exports. Under the new system, the top aggregation of goods trade now contains 11 so-called sections, which the text refers to as *sectors*. Divisions, the next -largest group, are now referred to as *sub-sectors*. The new terminology makes it difficult to directly compare this year's sectoral performance with that of previous years.



third consecutive year of recovery, gaining 14.9 percent in exports (up \$8.9 billion), which testified to the rebuilding of the North American automotive value chain. Most of this recovery was in actual volumes—exports were up 13.9 percent in constant dollar terms—while prices increased only 0.9 percent. At the sub-sector level, the bulk of the increase was due to passenger cars and light trucks, which gained 19.4 percent, or \$7.6 billion, in export value to reach \$46.9 billion. Exports of engines, tires and parts grew 6.5 percent, adding \$1.2 billion to the total growth.

**Metal and non-metallic mineral products** was Canada's third-largest export sector, with \$54.4 billion in exports last year. Exports fell by \$4.6 billion, or 7.8 percent, in value in 2012. This decline was the first since the Great Recession, with a 5.1-percent fall in prices accounting for the bulk of the decline in this sector. In constant dollar terms, however, the decline was

only \$1.6 billion, or 2.8 percent. At the sub-sector level, most of the decline occurred in intermediate metal products, which accounts for 80 percent of Canada's exports in this sector and consists of exports of unwrought metals and alloys. Exports of these fell 9.4 percent, or \$4.5 billion; nickel exports fell 21.9 percent; copper exports fell 19.9 percent; and aluminum exports fell 14.3 percent. Exports of precious metals and alloys, the largest component of this sub-sector, also went down 7.4 percent. In other sub-sectors, exports of fabricated metal products went up 4.6 percent and exports of non-metallic mineral products increased 5.9 percent, while exports of recyclable waste and scrap declined by 6.4 percent—from \$6.0 billion to \$5.6 billion.

In the newly defined **consumer goods** sector, exports amounted to \$48.5 billion, a decline of 2.6 percent, or \$1.3 billion, from the 2011 level. The decline was caused partly by prices (down 1.2 percent) and partly by volumes (down 1.5

percent). Exports in the largest sub-sector in this area—food, beverages and tobacco products—remained nearly constant (up 0.4 percent to \$20.9 billion). Exports of clothing, footwear and textiles edged up 3.1 percent to \$4.2 billion, and exports of furniture increased by 4.3 percent to \$4.2 billion. By contrast, exports declined in paper and publishing products (down 6.6 percent to \$4.0 billion), pharmaceutical and medicinal products (down 5.1 percent to \$5.9 billion) and miscellaneous products (down 10.4 percent to \$9.3 billion).

**Basic and industrial chemical, plastic and rubber products** exports declined by 7.7 percent, or \$2.8 billion, to \$33.0 billion in 2012. In constant dollar terms, the decline was larger—down 9.5 percent—while export prices in the sector increased 1.9 percent. Exports of plastic and rubber products were unchanged relative to 2011, with the overall decline in the sector entirely due to the basic chemicals and industrial chemical products sub-sector; petroleum refinery products were hit particularly hard, losing 18.2 percent in value, or \$1.3 billion.

**Forestry products** exports registered an increase of 0.5 percent, or \$0.2 billion, to reach \$30.6 billion last year. The 2.1-percent rise in prices was responsible, as actual volumes in constant dollars declined 1.6 percent. While exports of logs and other forestry products remained stable, exports of pulp and paper stock fell considerably (down 11.2 percent, or \$1.5 billion). This fall was offset by a rise in the exports of building and packaging materials (up 10.1 percent, or \$1.7 billion).

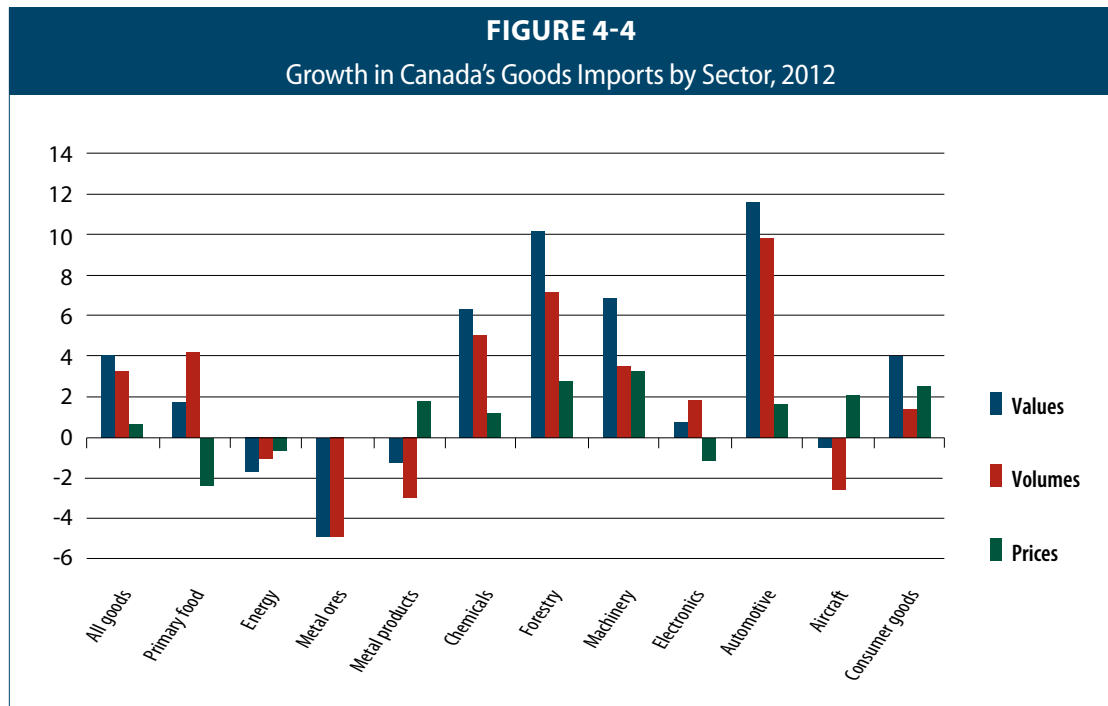
Exports of **metal ores and non-metallic minerals** fell 8.5 percent last year, losing \$1.7 billion in value. Total exports in this sector fell from \$20.2 billion in 2011 to \$18.5 billion in

2012. The decline in this sector was the first since the Great Recession. This fall was almost evenly distributed between prices and volumes—the former fell 4.2 percent during the year while the latter decreased by 4.5 percent. At the sub-sector level, metal ores and concentrates fell 5.8 percent (down \$0.6 billion)—driven by declining exports of copper, nickel and radioactive ores and concentrates. Exports of non-metallic minerals decreased more, by 11.2 percent (down \$1.1 billion), with the losses split evenly between potash, on one hand, and diamonds and other non-metallic minerals, on the other.

**Industrial machinery, equipment and parts** exports went up 5.6 percent in 2012, gaining \$1.4 billion to reach \$26.8 billion. In constant dollar terms, exports went up 4.0 percent, while prices grew 1.6 percent. A large expansion took place in agricultural machinery exports (up 23.4 percent, or \$0.2 billion), general purpose machinery (up 6.5 percent, or \$0.5 billion) and miscellaneous parts of machinery and equipment (up 5.0 percent, or \$0.4 billion).

**Electronic and electrical equipment and parts** exports contracted slightly, losing 1.3 percent in value to end at \$22.9 billion (down \$0.3 billion). Volumes contracted somewhat more, shrinking by 2.6 percent, while prices grew 1.4 percent. Exports of computers and peripheral equipment fell the most, losing 5.8 percent in value (down \$0.1 billion). Exports in the larger sub-sectors—communications, audio and video equipment and other equipment—were roughly stable.

Exports of **metal ores and non-metallic minerals** fell 8.5 percent last year, losing \$1.7 billion in value. Total exports in this sector fell from



\$20.2 billion in 2011 to \$18.5 billion in 2012. The decline in this sector was the first since the Great Recession. This fall was almost evenly distributed between prices and volumes—the former fell 4.2 percent during the year while the latter decreased by 4.5 percent. At the sub-sector level, metal ores and concentrates fell 5.8 percent (down \$0.6 billion)—driven by declining exports of copper, nickel and radioactive ores and concentrates. Exports of non-metallic minerals decreased more sharply, by 11.2 percent (down \$1.1 billion), with the losses split evenly between potash, on one hand, and diamonds and other non-metallic minerals, on the other.

**Aircraft and other transportation equipment and parts** exports grew 6.7 percent last year, increasing \$1.1 billion to reach \$17.3 billion. Most of the increase was due to volumes, since in constant dollar terms exports rose 5.2 percent while prices increased 1.5 percent. Aircraft exports expanded 7.4 percent, gaining \$1.0

billion to reach \$14.3 billion, while exports of locomotives, railway stock and ships fell 25.4 percent (down \$0.3 billion). Exports of boats and other personal transportation equipment increased by 18.0 percent (up \$0.3 billion).

Total imports of goods grew 4.1 percent last year, indicating that the domestic economy remained strong relative to the rest of the world. Most of the increase was due to a 3.3-percent growth in volumes, while import prices increased by just 0.7 percent. Overall, goods imports grew by \$18.5 billion to reach \$474.5 billion in 2012, setting another record. Seven out of eleven major sectors registered growth in imports, while four registered declines last year.

**Consumer goods** imports expanded by 4.0 percent, adding \$3.6 billion to reach \$93.0 billion. In constant dollar terms, imports expanded only slightly—by 1.4 percent—while prices (up 2.6 percent) were responsible for most of the increase. Most of the expansion occurred

in the two largest sub-sectors: food, beverage and tobacco products, where a gain of 8.1 percent added \$1.7 billion to imports; and cleaning products, appliances and miscellaneous goods, where imports gained 5.8 percent and added \$1.4 billion to imports. Imports of furniture expanded 8.2 percent, adding \$0.4 billion to the total. Imports of clothing, footwear and textile products grew 2.5 percent; paper and publishing imports were stable; while imports of pharmaceutical and medicinal products decreased 2.4 percent (down \$0.3 billion).

**Motor vehicles and parts** imports experienced the biggest increase in both absolute and relative terms. Imports went up 11.7 percent, or \$8.7 billion, to reach \$82.8 billion—mirroring the increase on the export side of the automotive value chain. Volumes expanded 9.8 percent, while prices increased only 1.7 percent. The tires, engines and parts sub-sector was responsible for most of the expansion (up 11.7 percent), adding \$4.1 billion to reach \$38.7 billion for the year. Passenger car imports expanded by \$3.0 billion (up 9.8 percent), while truck imports grew \$1.6 billion, which was the fastest growth in relative terms (up 18.5 percent).

**Electronic and electrical equipment and parts** imports changed little in 2012, registering a small increase of 0.7 percent. This added \$0.4 billion to the total value, which at \$55.5 billion was the third-highest among the sectors. In constant dollar terms, imports expanded 1.9 percent, but prices decreased 1.1 percent, negating most of that expansion. On the sub-sector level, falling imports of computers and peripheral equipment (down \$0.1 billion) were offset by rising imports of communications, audio and video equipment (up \$0.2 billion). In the other electronic and electrical machinery, equipment and parts sub-sector, imports of

electronic and electrical parts fell (down \$1.5 billion, or 15.8 percent), but that fall was offset by a rise in imports of electrical components and other electronic and electric machinery and equipment, for a total increase of \$0.3 billion, or 1.1 percent, for that sub-sector.

**Energy products** imports fell 1.8 percent, or \$0.8 billion, to \$45.7 billion last year. Volumes went down 1.1 percent, and prices decreased 0.7 percent. Crude oil imports still increased significantly (up 9.7 percent, or \$2.7 billion), but most other categories underwent declines. Natural gas imports declined 25.1 percent, from \$5.1 billion to \$3.8 billion; refined oil imports fell 18.6 percent, or \$2.2 billion; and electricity imports, though small to begin with, contracted 37.4 percent from \$370 million to \$232 million.

Imports of **industrial machinery, equipment and parts** expanded by \$2.9 billion to reach \$45.2 billion, an increase of 6.9 percent. This rise was split almost evenly between rising volumes (up 3.5 percent) and prices (up 3.2 percent). The increase was broad-based; imports of miscellaneous parts of machinery and equipment expanded the most, followed by logging, mining and construction machinery and equipment and then by agricultural, lawn and garden machinery and equipment.

**Metal and non-metallic mineral products** imports declined by \$0.6 billion, or 1.3 percent, to \$43.5 billion. Volumes fell 3.0 percent while prices increased 1.8 percent. The decline stemmed primarily from the fall in the intermediate metal products and recyclable waste and scrap sub-sectors. These declines in turn were mostly driven by reductions in imports of

precious metals and alloys. Increasing imports of fabricated metal products and non-metallic mineral products partly offset this decline.

**Basic and industrial chemical, plastic and rubber products** imports rose \$2.3 billion, or 6.3 percent, in value to reach \$38.1 billion in 2012. This represented 5.1-percent expansion in volume terms, with prices also increasing, by 1.2 percent. The basic chemicals and industrial chemical products sub-sector accounted for more than half of the value of these imports, and that sub-sector is where most of the increase took place: imports were up \$1.9 billion, or 9.3 percent. Lubricants and other petroleum refinery products led the way: up 18.4 percent, or \$1.0 billion.

Imports of **forestry products and building and packaging materials** grew quickly at 10.2 percent, adding \$1.9 billion in value to reach \$20.5 billion in 2012. In constant dollar terms, imports grew 7.2 percent while prices increased 2.8 percent. The building and packaging materials sub-sector was entirely responsible for this increase while imports of logs and pulp remained stable.

**Aircraft and other transportation equipment and parts** imports changed very little during the year, edging down 0.5 percent, or \$69 million, to \$12.7 billion. Volumes declined 2.6 percent while prices increased 2.1 percent. Rising imports of aircraft engines and parts offset the decline in aircraft imports, contributing to the overall growth in the aircraft sub-sector; meanwhile imports of ships, locomotives and railway stock declined.

**Farm, fishing and intermediate food products** was the second-smallest import sector and posted a growth of 1.7 percent in 2012, up

\$0.2 billion, to reach \$12.3 billion. Volumes expanded 4.2 percent, while the 2.4-percent fall in prices mitigated the increase in value. In a broad-based increase, imports grew for wheat, canola, and fruits, nuts and vegetables, yet declined for other crops. Imports of food and tobacco intermediate products also increased.

**Metal ores and non-metallic minerals** was the smallest import sector in 2012, with \$10.0 billion worth of imports. This represented a decline of \$0.5 billion, or 4.9 percent, from the 2011 level of \$10.6 billion. The decline was due to the 4.9-percent decline in volumes, while prices remained constant. Declining imports of nickel, radioactive and other ores and concentrates contributed to this fall.

### Services Trade

In 2012, the recovery in the services trade continued, though at a slower pace. After 5.8-percent growth in 2011, Canadian exports of services grew 0.3 percent, adding \$0.2 billion to the total to end at \$84.1 billion. However, since services trade did not experience the same drastic contraction as goods trade during the Great Recession, this level was 5.0 percent above the 2008 level. Imports of services, like exports, also reached an all-time high, hitting \$108.3 billion after a 1.7-percent increase (up \$1.8 billion). As a result, Canada's services trade deficit widened by \$1.6 billion to reach \$24.2 billion in 2012. The bulk of the increase in the deficit came from a growing deficit in travel services (a \$16.3-billion deficit last year, mostly in the personal travel sub-category). The other significant source of the increase in deficit was in technical, trade-related and other business services. Trade in services constituted 17.0 percent of Canada's total trade in 2012, slightly down from 2011.



	Exports			Imports			Balance		
	2011	2012	% growth	2011	2012	% growth	2011	2012	\$ change
<b>Total, all services</b>	83,850	84,086	0.3%	106,469	108,290	1.7%	-22,619	-24,204	-1,585
<b>Travel</b>	16,624	17,387	4.6%	32,974	35,030	6.2%	-16,350	-17,643	-1,293
Business travel	2,865	2,899	1.2%	4,120	4,273	3.7%	-1,255	-1,374	-119
Personal travel	13,760	14,490	5.3%	28,855	30,757	6.6%	-15,095	-16,267	-1,172
<b>Transportation</b>	13,587	13,508	-0.6%	23,673	23,696	0.1%	-10,086	-10,188	-102
Water transport	2,733	2,654	-2.9%	10,128	9,928	-2.0%	-7,395	-7,274	121
Air transport	6,283	6,359	1.2%	10,156	10,279	1.2%	-3,873	-3,920	-47
Land and other transport	4,571	4,496	-1.6%	3,391	3,489	2.9%	1,180	1,007	-173
<b>Commercial services</b>	52,072	51,597	-0.9%	48,516	48,247	-0.6%	3,556	3,350	-206
Maintenance and repair services	1,371	1,489	8.6%	299	613	105.0%	1,072	876	-196
Construction services	482	353	-26.8%	406	336	-17.2%	76	17	-59
Insurance services	2,174	2,133	-1.9%	5,857	5,857	-7.7%	-3,683	-3,272	411
Financial services	6,883	6,917	0.5%	5,160	5,379	4.2%	1,723	1,538	-185
Communication services	9,520	9,800	2.9%	4,919	5,090	3.5%	4,601	4,710	109
Charges for the use of intellectual property	3,311	3,742	13.0%	10,300	10,855	5.4%	-6,989	-7,113	-124
Professional and management services	11,402	11,753	3.1%	10,133	9,736	-3.9%	1,269	2,017	748
Research and development	4,320	3,981	-7.8%	1,127	805	28.6%	3,193	3,176	-17
Technical, trade-related and other business services	10,120	9,070	-10.4%	8,303	7,980	-3.9%	1,817	1,090	-727
Personal, cultural, and recreational services	2,488	2,361	-5.1%	2,012	2,047	1.7%	476	314	-162
<b>Government services</b>	1,567	1,593	1.7%	1,302	1,317	1.2%	265	276	11

Source: Statistics Canada, CANSIM Table 376-0108

Canada traditionally runs a services trade deficit with its major trading partners, and 2012 was no exception. The largest of these deficits is with the United States (\$16.4 billion, or 67.7 percent of the total), followed by the EU at \$3.0 billion and Japan at \$0.3 billion. The services deficit with the rest of the OECD countries is \$1.2 billion, and the rest of the deficit (\$3.3

billion) is with the non-OECD countries. The bulk of the increase in the services deficit last year was due to the growing deficit in travel and commercial services with the United States.

**Travel and tourism services** continued to drive Canada's trade deficit in services. Imports of travel services (Canadians travelling abroad)



traditionally exceed exports (foreigners traveling to Canada) by a wide margin. Imports of travel services, i.e. foreign travel expenditures by Canadians increased 6.2 percent, up \$2.1 billion, with the bulk of those expenditures in personal travel. Spending by foreigners traveling to Canada grew only 4.6 percent, or \$0.8 billion. Imports of travel services thus set a new record, at \$35.0 billion. These developments fully account for the deterioration in the services trade balance.

**Transportation services** trade was stable in 2012, with exports going down 0.6 percent while imports grew 0.1 percent. The combined effect of these changes on the trade balance was just \$102 million. Exports and imports of water transport services declined (down 2.9 percent and 2.0 percent, respectively) while exports and imports of land and other transport services increased (up 1.6 percent and 2.9 percent, respectively). Air services exports and imports each rose 1.2 percent.

**Commercial services** trade continued to produce an atypical surplus for Canada, now in its third year. The revision of 2011 data showed that the trade surplus in this category was \$3.6 billion rather than \$0.9 billion, as reported previously; this edged down slightly to \$3.4 billion in 2012.

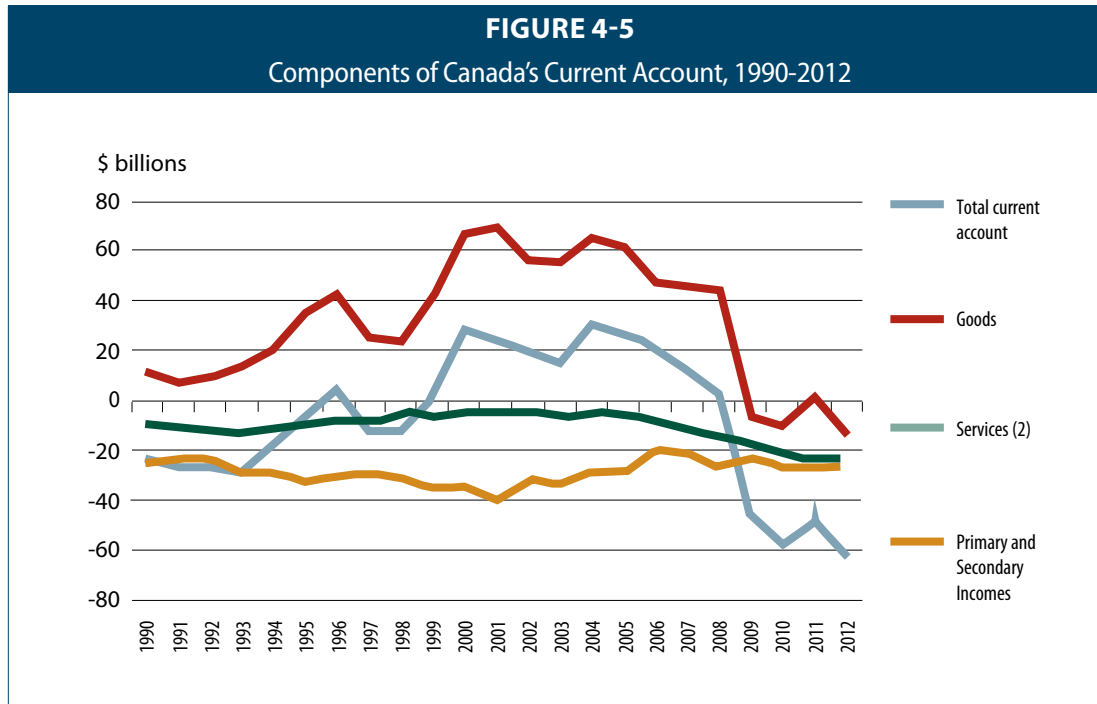
Exports of commercial services decreased by \$0.5 billion, down 0.9 percent, while imports lost \$0.3 billion, down 0.6 percent. The revision of 2011 export values for commercial services put them at \$52.1 billion; in 2012, the total value was \$51.6 billion. Only one category—charges for the use of intellectual property (formerly royalties and licence fees)—grew rapidly during the year, adding \$0.4 billion, or 13.0 percent, in value to exports. Slower growth

took place in financial, communication, professional and management, and maintenance and repair services. A decline took place in exports of technical, trade-related and other business services (down \$1.1 billion, or 10.4 percent); construction services also declined considerably (down \$129 million, or 26.8 percent). Other export categories that declined were research and development; personal, cultural and recreational services; and insurance services. Imports of maintenance and repair services, charges for the use of intellectual property and personal, cultural and recreation services increased by \$0.3 billion, \$0.6 billion and \$0.04 billion respectively; declines took place in imports of research and development services (down \$0.3 billion), professional and management services (down \$0.4 billion) and insurance services (down \$0.5 billion).

### The Current Account

The current account records the flow of all within-the-year transactions between Canada and its commercial partners. The goods trade is the dominant component of these transactions, with the services trade a distant second. These two are discussed at length in earlier sections of this chapter. The other two components of the current account were traditionally known as investment income and current transfers, but a change in classification this year resulted in new entries: *primary and secondary income*. Receipts on those items can be thought of as exports and payments as imports.

**Primary income** flows consist of receipts and payments on direct investments, portfolio investments and other investments, as well as compensation of employees. In Canada, this is usually a deficit item; in 2012, this deficit decreased by \$0.7 billion to \$22.4 billion. Receipts of Canadian investors grew \$3.3



billion, with portfolio investments and direct investment receipts increasing. Payments to foreign investors increased by \$2.5 billion, with direct investment payments relatively stable and portfolio investment payments increasing. Overall, direct investment flows typically account for the greatest proportion of short-term financial flows in this category and are largely evenly balanced between receipts and payments. The portfolio investments deficit accounted for most of Canada's deficit in investment income in 2012.

**Secondary income**, the smallest component of the current account, represents current transfers. The deficit associated with these increased by \$0.06 billion to \$3.5 billion in 2012. Receipts were up \$0.3 billion, due to government transfers; transfer payments to foreigners

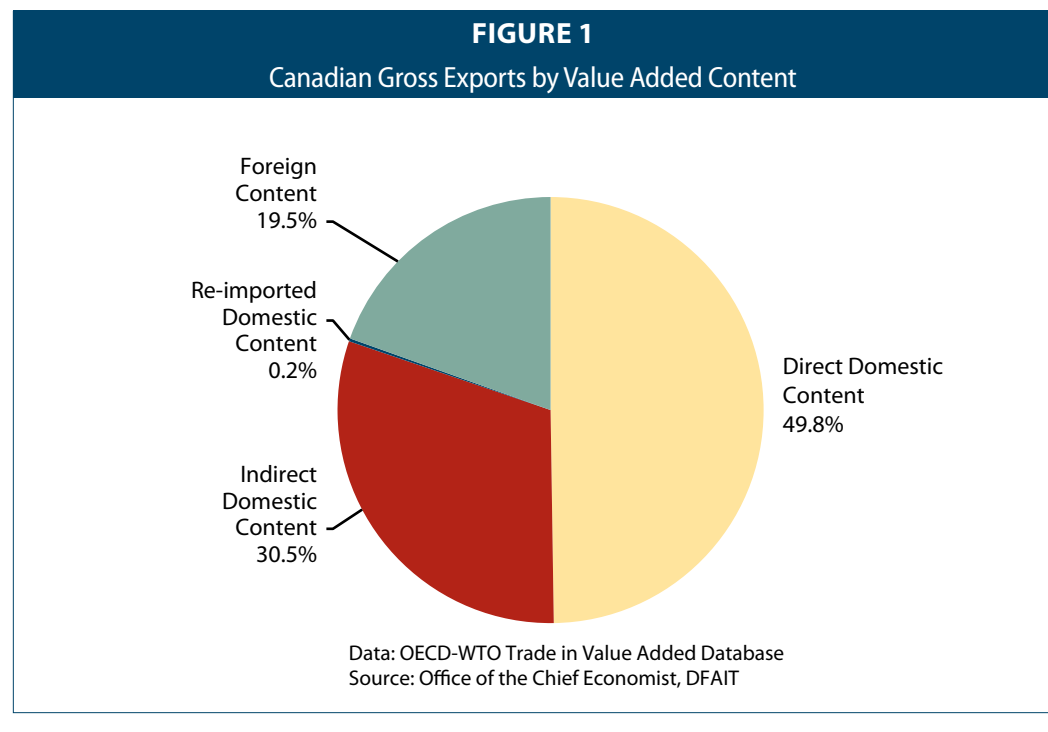
increased \$0.3 billion, mostly due to increase in foreign taxes paid.

The developments previously described in this chapter, as well as considerable revisions in Statistics Canada's methodology and calculations that took place this year, have resulted in Canada's total **current account** deficit (as the sum of all its components) reaching \$62.2 billion in 2012. This is a significant increase of \$13.7 billion over 2011, which stems from a \$12.8-billion deterioration in the trade balance for goods and a \$1.6-billion widening of the trade deficit for services. The primary income deficit shrunk by \$0.7 billion, and the secondary income deficit widened by \$0.06 billion—which produced Canada's fourth consecutive current account deficit. ■

## Trade in Value Added—Implications for Canada

Global value chains (GVCs) have become a prominent part of international trade. The process of producing a good or service is increasingly distributed across many countries, resulting in intermediate inputs being sourced from countries that can supply them most efficiently. The value created along GVCs in each country can be hard to measure because traditional gross measures tend to double count intermediate imports that are used as inputs to exports. The Trade in Value Added (TiVA) database, recently released by the Organisation for Economic Co-operation and Development (OECD) and the World Trade Organization (WTO), presents a new way to measure international trade. Derived from OECD Input Output tables, the TiVA database provides estimates for the source of value added, by industry and country, in producing traded goods and services. While gross trade statistics remain essential, value-added trade provides a complementary perspective that accounts for the movement of intermediate goods and services through many countries, allowing for better measurement of GVCs.

Value-added trade distinguishes between the foreign and domestic content of exports and imports. The domestic content measures how much value added is generated throughout the domestic economy while foreign content represents the value added generated elsewhere in the world. For example, Canada may export a car. The chassis, wheels and interior may be

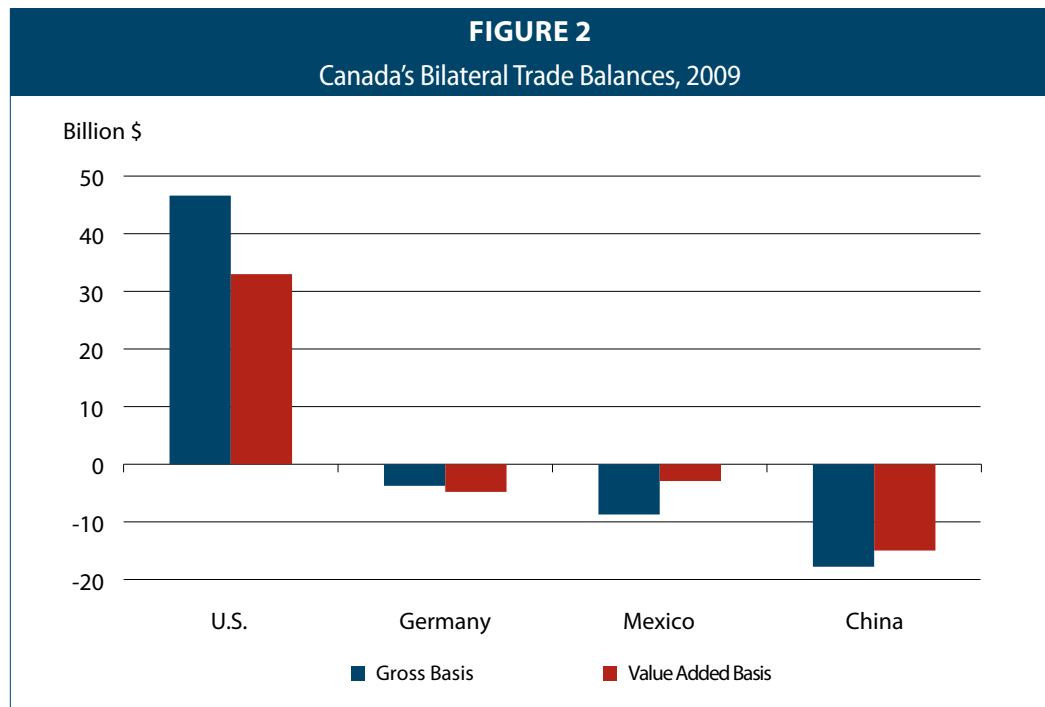


produced in Ontario while the engine is produced in Detroit. The engine is then imported by Canada, which subsequently exports the finished car abroad. In this case, the domestic content comprises the chassis, wheels and interior and the foreign content would include the value of the engine. In an economy where the foreign content of exports is high, the importance of imports to exports is greater.

Canada's exports contain, on average, 19.5 percent foreign content and 80.5 percent domestic content. Canadian exports have a slightly higher domestic content than other OECD members, whose exports contain, on average, 29.0 percent foreign content and 71.0 percent domestic content. The domestic content of Canada's exports can be further divided into direct domestic content (49.8 percent), indirect domestic content (30.5 percent) and re-imported domestic content (0.2 percent). **Direct content** is value that originates directly from the same Canadian industry from which it is being exported; **indirect content** is value originating from Canadian intermediates produced in industries apart from the industry reporting the export. **Re-imported domestic content** is value that originates from products or services that were previously exported by Canada and subsequently re-imported.

Canada's high domestic content of exports can be partly explained by its resources. Mining, for example, accounts for 23.0 percent of Canadian exports and, as such, represents Canada's largest export sector. Because of its position at the beginning of the value chain, mining holds the largest share of direct domestic content of all Canadian industries, as well as the lowest share of foreign content, at 73.5 percent and 6.5 percent, respectively. Canadian exports from other sectors all have higher levels of foreign content. For example, exports from Canada's transport equipment industry contain the highest share of foreign content and re-imported domestic content of all Canadian industries, at 36.0 percent and 0.5 percent, respectively. This is because of the high degree of integration in this industry between Canada and the United States.

Canada's bilateral trade balances measured on a value-added basis differ from those measured on a gross basis. Figure 2 shows that Canada's trade surplus with the United States is less when measured in value-added terms than in gross terms. This is because of the high level of U.S. intermediate goods and services used in Canadian exports. This lower surplus is offset by increased surpluses or decreased deficits with other countries as Canada's net balance with the world must remain the same. For example, on a value-added basis, Canada's trade deficits with China and Mexico appear smaller than on a gross exports basis, as the direct exports from these countries into Canada embody more foreign content than their indirect contribution to the exports of other countries into Canada. Value-added measures also alter the trade picture by changing the distribution of value that is exported. For example, on a value-added basis, the United States accounts as a destination for 61 percent of Canada's exports and

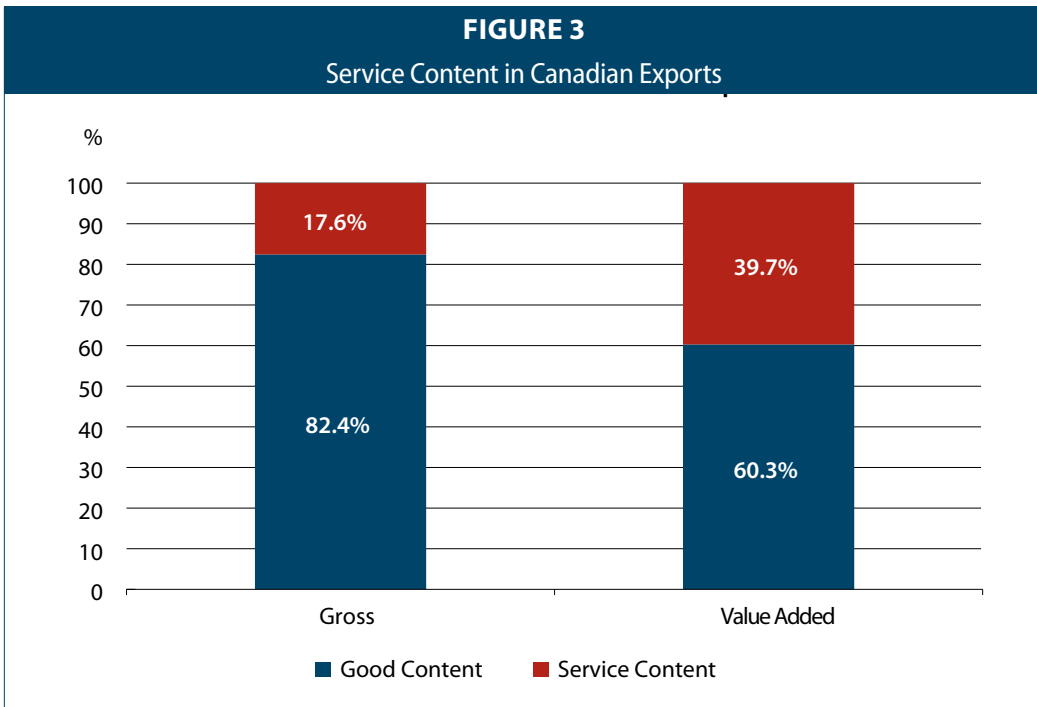


48 percent of its imports, whereas on a gross basis, the United States accounts for 70 percent of exports and 62 percent of imports.<sup>1</sup> The difference between the two measurements reflects the significant intermediate input trade between Canada and the United States.

Value-added trade measurements also emphasize the importance of services, particularly the importance of services as inputs into Canadian exports. Service content includes activities such as distribution and repair, and transport and storage, which provide important links in supply chains, as well as finance or business services, which improve the efficiency of goods production.<sup>2</sup> Figure 3 compares the service content of exports on a gross basis with the service content on a value-added basis. At 36.8 percent of exports, the services component of exports on a value-added basis is more than double the services component on a gross basis. This is primarily because of the high level of indirect domestic service content, which makes up 20.0 percent of exports. Value-added trade demonstrates that even non-service industries embody a significant amount of service content, in this case an average of 21.6 percent across industries.

1 Using value-added rather than gross measurements affects the U.S. share of Canadian imports less than the U.S. share of exports because its domestic content is higher. The higher the share of domestic content, the smaller the difference between gross values and value-added values.

2 At this time, the share of such activities in the service content of Canadian exports is unknown as the OECD and WTO have yet to publish data for specific countries. On a world basis, distribution and repair, and business services account for the largest share of service content in manufacturing industries.



Value-added trade presents a new perspective on international trade and gives useful insight into GVCs. It does not directly measure trade flows, unlike official trade statistics, but instead, by relying on important assumptions, estimates high-level industry aggregates. Value-added trade is also less up-to-date than official trade statistics. Value-added trade provides a new analytical tool to assess the role of trade but should be treated as a complement to, rather than a substitute for, traditional trade statistics. ■





# Key Developments in Canadian Merchandise Trade in 2012

The previous chapters discussed the difficult global economic situation and the continuing recovery of Canada's economy and trade in 2012. While not as fast as in the two previous years, Canada's recovery was more stable and sustained than that of most other countries. Continued strength in domestic demand and solid financial and fiscal fundamentals allowed for continued growth in merchandise imports, while merchandise export growth moderated. Both the slowdown in global economic activity—with many of Canada's strongest export destinations in the throes of another recession—and the weakening in export prices for resource-based commodities—of late among Canada's main export strengths—have contributed to that slowdown. The big news in 2012 was Canada's improving trade with the United States, as the U.S. economy started lifting itself from the depths of the recession in the second half of the year. Recovery south of the border gathered speed, with rising employment and an improving outlook for the housing sector, which fuelled demand for some Canadian exports. For the first time in over a decade, the U.S. share as both export destination and import supplier increased, reversing the long trend of decline. Canadian merchandise trade also bucked the diversification trend in 2012, as dependence on major import suppliers and export destinations increased somewhat.

This chapter takes a closer look at the developments in Canada's merchandise trade over the course of 2012, with the use of Customs data on merchandise trade permitting a more detailed analysis of trade statistics—by destination country, commodity and province of origin. These data differ from the balance of payments (BOP) data used in chapter 4.<sup>1</sup>

Total Canadian merchandise exports increased to \$454.4 billion in 2012, but were outstripped by total merchandise imports, which increased to \$462.1 billion, plunging Canada's merchandise trade balance back into deficit by \$7.7 billion. Global economic weakness meant that exports decreased to 7 of Canada's top 10 export destinations and to 13 of the top 20. The only 3 destinations out of the top 10 to which exports expanded were the United States (1st), China (2nd) and France (9th), but these increases were enough to ensure overall export growth. Thus the post-recession recovery in Canadian merchandise exports continued at a slower rate as recession continued to grip Canada's other major trading partners (e.g., the EU and Japan). Meanwhile, merchandise imports reached a new all-time high, with growth the rule rather than the exception, as 7 of the top 10 import sources and 13 of the top 20 increased their shipments to Canada, led by the United States and China, Canada's top two partners, followed by Japan and Germany.

1 Canadian trade statistics are provided in two basic forms: Customs basis and Balance of Payments basis. In Chapter Four, the analysis of trade with "major partners" used trade data prepared on the Balance of Payments basis. More detailed trade statistics—at the individual country levels and by detailed commodity—are available on a Customs basis only. As Chapter Five examines trade developments in detail, the data in this chapter are provided on a Customs basis. See endnote for details on Customs vs. BOP data.

Canada conducts the bulk of its trade with very few partners, and its merchandise exports are especially concentrated: in 2012, 74.5 percent of all Canadian exports ended up in the United States. Indeed, the United States, China and the United Kingdom together accounted for 82.9 percent of all exports while the top 10 export destinations together accounted for 90.3 percent, up from 89.7 percent in 2011. The share of the top 20 export destinations also increased slightly—from 94.3 percent in 2011 to 94.5 percent in 2012.

Canada's number one supplier, the United States, accounted for just over half of Canada's imports while the top three suppliers together accounted for just over two thirds of all imports. The top 10 suppliers accounted for 80.2 percent of total Canadian merchandise imports (up from 79.1 percent in 2011), while the top 20 together accounted for 88.1 percent (also up significantly, from 86.9 percent in 2011). Lesser import concentration is due to the lesser import dependence on the United States, as evidenced by the \$104.9 billion trade surplus with that country in 2012. There are few other countries that Canada ran a significant merchandise trade surplus with in 2012: \$10.2 billion with the United Kingdom; \$2.2 billion with Hong Kong; and \$1.0 billion with the Netherlands. Canada's large trade surplus with the United States enables Canada to run trade deficits with most other countries, including China (\$31.4 billion), Mexico (\$20.1 billion), Germany (\$10.7 billion) and Algeria (\$5.6 billion).<sup>i</sup>

2012 was marked by considerable reshuffling among Canada's top 10 export destinations. The major change was China passing the United Kingdom to become Canada's second-largest export destination. South Korea ceded the sixth position to the Netherlands following a drop in exports from Canada, and Brazil

beat Hong Kong to the 10th place (see Figure 5-1). By contrast, on the import side, the top 10 positions remained largely unchanged; only France slipped two spots to end the year behind Algeria and Italy (see Figure 5-2).

Energy products continued to exert a major impact on Canada's trade performance in 2012, with crude oil generating the largest single-product surplus (\$44.5 billion). However, the passenger cars category contributed the largest overall change to Canada's trade balance last year (up \$4.9 billion) and also generated Canada's second-largest surplus, by far (\$21.0 billion). Of note, passenger cars was the only non-resource item among the top 10 surplus commodities, which included petroleum gases, wheat, potash, gold, wood, coal, aluminum and canola. On the other hand, manufactured products—including trucks, automotive parts, computers, telecom equipment and medications—were responsible for most of the trade deficits; in general, trade deficits in these commodities widened during last year. By contrast, most trade surplus commodities registered higher surpluses, with significant exceptions: petroleum gases, potash, gold, coal and aluminum all generated lower surpluses in 2012 compared to 2011.

In the resource sector, the tendency of export prices was generally to the downside in 2012, creating an unfavourable shift in Canada's terms of trade. Energy prices went down nearly 10 percent overall, driven by large drops in the prices of natural gas and electricity. Crude oil prices dropped slightly overall, while prices of refined oil products were approximately the same as the year before. Prices for metal ores and concentrates decreased across the board, dragging down the prices of intermediate metal products while keeping fabricated metal prices constant. Lower prices also prevailed

in chemical exports. By contrast, food prices increased, and most of the manufacturing sectors registered small increases as well, including machinery, electronic and electrical equipment, aircraft, and consumer goods.

Price tendencies were similar on the import side, with a few exceptions. Prices for refined oil products declined slightly, but the fall in gas and electricity prices was less sharp than on the export side. Metal ore and concentrates prices fell only marginally, and prices of imported chemicals increased. Prices of imported electronic and electrical equipment remained stable.

Export volumes increased sizeably for wheat and other crops, crude and refined oil, electricity, basic non-ferrous metal products, agricultural machinery and equipment, passenger cars, aircraft engines and parts, and textile products. Export volumes dropped for coal, nickel ores, potash, unwrought precious metals, basic and industrial chemicals, metalworking machinery, published products and recorded media, and tobacco products. Import volumes grew considerably for wheat, canola, fish and seafood, potash, industrial chemicals, forestry products, building and packaging materials, passenger cars, trucks, meat products and beverages. Imports volumes declined in the following areas: natural gas liquids, refined oil, electricity, iron ores, diamonds, unwrought precious metals, waste and scrap, electronic and electrical parts, aircraft, ships and railways stock (and their parts).

The revival of the North American automotive sector was the biggest sectoral trade story of the year, with Canada's exports of passenger cars jumping 19.1 percent and exports of motor vehicle parts rising 9.0 percent. Rising imports also contributed to this increased trade, up

11.1 percent for passenger cars, up 11.9 percent for motor vehicle parts and up 7.5 percent for trucks. The continuing U.S. economic recovery also helped Canada's wood sector exports, which went up 10.2 percent.

Exports of petroleum gases continued to lose steam, declining by nearly a third in 2012, as the cheap gas available in the United States further depressed Canada's export prices and volumes. Coal exports also took a hit, declining by over 20 percent. The rise in potash exports, which have tripled in the last five years, also came to a halt, declining nearly 10 percent in 2012. On the other hand, exports of canola seeds and oil continued to grow, by 13.4 percent and 9.0 percent, respectively, and wheat exports grew by 8.2 percent. Metal exports mostly declined, with gold exports down 8.9 percent, aluminum exports down 14.9 percent, copper exports down 6.5 percent, nickel exports down 20.3 percent and silver exports down 36.7 percent.

Among manufactured products, exports of aircraft parts increased 19.1 percent while finished aircraft exports remained stable; exports of turbines went up 4.3 percent. Exports of telecom equipment declined 6.6 percent; exports of engines and of machinery parts rose by 6.0 percent and 8.1 percent, respectively. Exports of newsprint took a dive, losing 16.4 percent in value terms; paper exports declined 8.5 percent.

On the import side, Canada's imports of non-crude oil, primarily from the United States, moderated somewhat (down 6.4 percent), while most other major items (with the exception of the automotive sector discussed above) showed little change. Of the smaller items, imports increased for engines by 15.3 percent, for tractors by 18.4 percent and for bulldozers by 13.1 percent.

## Trade by Top 10 Partners

### Merchandise Exports

After two years of rapid recovery exceeding 10 percent a year, Canadian merchandise exports to the world increased only marginally in 2012, posting a gain of 1.5 percent (up \$6.9 billion) to \$454.4 billion. Growth weakened primarily because of moderating and, in some cases, declining resource prices and because of weak foreign demand, particularly in Europe. Total exports thus remained well below their \$483.5-billion peak in 2008. Canada's largest trading partners, i.e. in Europe, Japan and in North America, were still operating under capacity and in some cases were in the middle of another recession. Consequently, exports to the United States, Japan, Mexico, Germany, Belgium, France and Italy have yet to recover to their pre-recession levels. Continued and sustained recovery in these economies holds further promise for a recovery in Canada's merchandise trade.

Together, Canada's top 10 export markets accounted for 90.3 percent of its merchandise exports in 2012, an increase in concentration from 89.7 percent in 2011. Moreover, the concentration of the top 20 merchandise exports has now grown for three years—from 93.3 percent in 2009 to 94.5 percent in 2012. In 2011, Hong Kong was among the top 10 destinations for Canadian exports, receiving \$3.0 billion in Canadian exports, but with exports declining to \$2.5 billion in 2012 Hong Kong slipped out of the top 10, losing its tenth place position to Brazil.

The **United States** continued to be Canada's leading merchandise export destination in 2012, increasing its share to 74.5 percent, up from 73.7 percent in 2011—the first increase since 2002. As the U.S. economic recovery

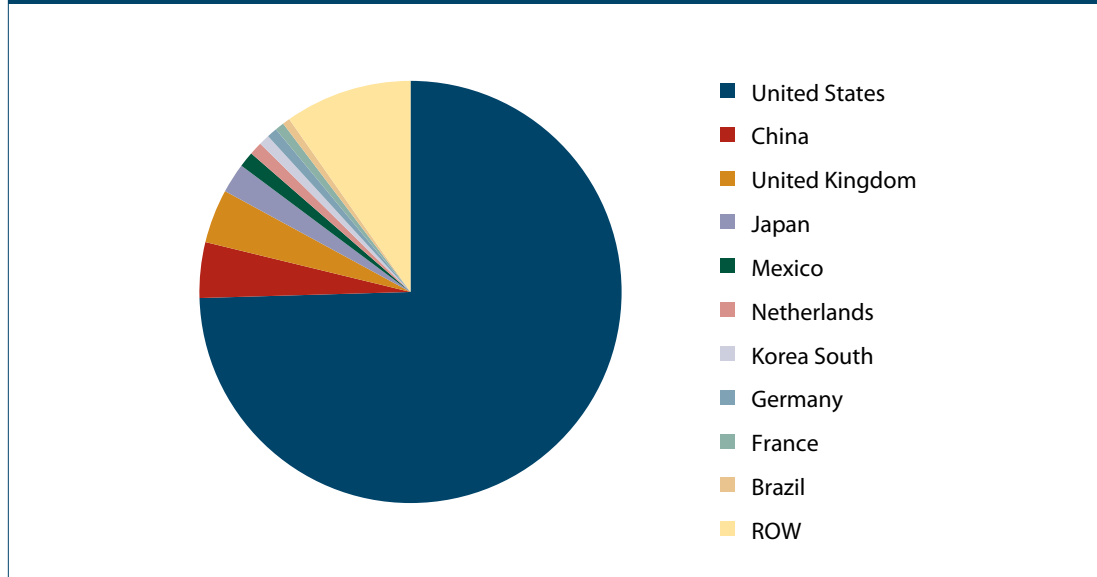
slowly gathered speed, Canada's exports to the United States grew faster than average, up 2.7 percent, or \$8.9 billion, to reach \$338.7 billion in 2012. Rising employment and a recovering housing market contributed to the improved economic picture south of the border. Political issues, however, continued to hamper an agreement on economic policy, with the continued uncertainty of the sequestering process casting a shadow over the recovery and in turn limiting Canada's opportunity to restore its exports to pre-recession levels. On the other hand, new opportunities developed due to the ongoing North American energy revolution and some prospects for a manufacturing revival in the United States.

Exports of mineral fuels and oils, Canada's top export category to the United States, grew only marginally—from \$104.1 billion in 2011 to \$105.8 billion in 2012, and consequently its share of total exports decreased from 31.6 percent to 31.2 percent. With the exception of natural gas, export volumes increased considerably in every category, especially in refined oil products. However, energy product prices generally declined—steeply for gas and electricity, moderately for crude oil—while prices increased slightly for refined oil products. These price movements largely offset each other and kept the value of Canada's energy exports to the United States stable.

Automotive exports drove the increase in exports to the United States, growing 16.2 percent as the recovery in the auto sector took hold—an \$8.1-billion gain, mostly in passenger vehicles. Exports of precious stones and metals took a dive (down \$2.8 billion, or 28.5 percent). Declines also occurred in exports of paper (down \$0.9 billion) and aluminum (down \$0.8 billion). By contrast, significant export gains

FIGURE 5-1

## Canada's Top 10 Export Destinations



took place in wood products (up \$1.1 billion), mechanical machinery (up \$0.9 billion), and aircraft and parts (up \$0.7 billion).

**China** took over second place in the list of largest Canadian merchandise export destinations from the United Kingdom. Exports to China grew \$2.5 billion, or 15.1 percent, to \$19.3 billion, bringing China's share of Canada's total exports to 4.3 percent in 2012. Accounting for over half of this increase were exports of canola seeds, which more than doubled, from \$0.9 billion in 2011 to \$2.5 billion in 2012. Exports of ores, slag and ash, Canada's top export commodity to China in 2012, increased \$0.2 billion; wood pulp stayed in second place with marginal gains. The other significant gains occurred in mineral fuel and oil exports (up \$0.8 billion, or nearly 60 percent) and canola oil (up \$0.5 billion, over 75 percent). Wheat exports more than doubled, registering a \$0.2-billion gain. Exports of nickel lost a third of their 2011 value (down \$0.3 billion).

The **United Kingdom** slipped to third place in the rankings as Canada's exports declined marginally (down 0.2 percent) to end the year at \$18.8 billion. The U.K. share of all Canadian exports declined to 4.1 percent. The precious stones and metals category increased \$0.2 billion, or 1.7 percent, accounting for over two thirds of Canada's exports to the United Kingdom. Uranium exports declined \$0.1 billion, or 9.9 percent, and nickel exports contracted by \$0.3 billion, or 26.4 percent. Meanwhile, exports of aircraft and parts increased by \$0.2 billion, and exports of mineral fuels and oils more than doubled, from \$0.2 billion in 2011 to \$0.5 billion in 2012. Aluminum exports, which stood at \$159 million in 2011, lost over 80 percent of that value in 2012.

**Japan** remained in fourth place in 2012, absorbing \$10.4 billion in merchandise exports from Canada, down \$0.3 billion, or 3.0 percent, from 2011—due exclusively to mineral

fuels and oil (mostly coal), the top export article. Despite continued growth in Canada's exports of canola seeds to Japan, up \$0.2 billion during the year to reach \$1.9 billion, China replaced Japan as the number one destination for Canadian canola seeds. Most of the other export articles remained stable, with \$0.1-billion growth in exports of cereals offsetting the \$0.1-billion decline in wood pulp exports.

**Mexico** again ranked fifth as a destination for Canadian merchandise exports, which declined 1.6 percent during 2012, or \$89 million, to \$5.4 billion—just over half that of fourth-ranked Japan. The decline was caused by a steep fall in exports of electrical machinery and equipment—the top export article in 2010—which declined \$322 million, or 40.0 percent, to rank third in 2012. For the third consecutive year, exports of canola seeds grew significantly (up \$120 million) and remained Canada's top export commodity to Mexico. Exports of vehicles expanded by \$135 million while exports of mechanical machinery, and iron and steel grew by \$58 million and \$65 million, respectively.

**The Netherlands** improved its ranking for the second consecutive year, passing South Korea to rank sixth among Canada's top merchandise export destinations, even though exports declined 5.5 percent (\$265 million) to reach \$4.5 billion—exactly 1.0 percent of all Canadian exports in 2012. Declines occurred in exports of mineral fuels and oils, which fell by \$115 million (mostly due to falling coal exports); aluminum, which fell \$99 million; canola oil, which fell \$75 million; and wood, which fell \$53 million. Meanwhile, exports of metals and ores grew \$146 million (mostly iron ores and ash); exports of inorganic chemicals (mostly uranium) grew \$83 million; and exports of canola seeds grew \$70 million.

**South Korea** suffered the largest decline in Canadian exports to a single country, dropping from sixth to seventh place among Canada's top export destinations. Exports fell \$1.4 billion in 2012, or 27.2 percent, to \$3.7 billion—the 2010 level—thus making the 2011 increase transitory. Exports of mineral fuels and oil returned to 2010 levels, losing 40.6 percent of value (or \$776 million, all in coal). A decline of over 70 percent also took place in exports of cereals (down \$344 million), and meat exports fell \$93 million. Nickel exports fell \$69 million to half the 2011 value. Exports of electrical machinery, one of the few product categories to increase, rose 85.1 percent, or \$120 million.

**Germany** remained eighth in the rankings, even though Canada decreased its exports to that country 9.5 percent, or \$377 million, to \$3.6 billion in 2012. Over half of the decrease was due to the 40.8-percent reduction in aircraft exports, down \$212 million to the 2010 level, and implies a transitory increase (delivery contract) in 2011. The rest of the decline was due to the halving of exports of mineral fuels and oil, which were down \$124 million (coal and refined oil). Exports of canola seeds tripled, gaining \$98 million in value; however, canola oil exports lost \$53 million—nearly 90 percent of their 2011 total. Some increases also took place in exports of mechanical machinery, wood pulp, and electrical machinery.

**France** remained in ninth position in 2012, and along with the United States and China was among the few countries in the top ten to post growth. Building on the impressive growth of \$732 million in 2011, Canada's exports to France increased a further \$71 million (up 2.3 percent) to reach \$3.2 billion. A large increase in exports of mineral fuels and oil (up \$318 million, or 133.4 percent, all refined oil) was responsible. Exports of mechanical machinery,



the top export product, also grew, up 13.9 percent (or \$83 million), as did electrical machinery exports (up \$53 million). Exports for most other products declined, particularly aircraft and parts (down \$165 million); inorganic chemicals (down \$47 million; predominantly uranium); pharmaceutical products (down \$41 million); ores, slag and ash (down \$35 million); and canola oil (down \$35 million).

**Brazil** returned to the top 10 in 2012, although exports fell 9.2 percent, or \$262 million. As the destination for \$2.6 billion in total Canadian exports, Brazil ranked just ahead of Hong Kong, India, Norway and Belgium. Most of the decline took place in mineral fuels and oil exports, which fell by \$287 million, or 41.9 percent (all of that decline representing coal exports). Gains in other export items mostly balanced losses. Increases took place in exports of potash (up \$90 million); mechanical machinery (up \$37 million); and ores, slag and ash (up \$30 million), while declines were observed in exports of electrical machinery (down \$60 million); organic chemicals (down \$53 million); and paper (down \$18 million).

### Merchandise Imports

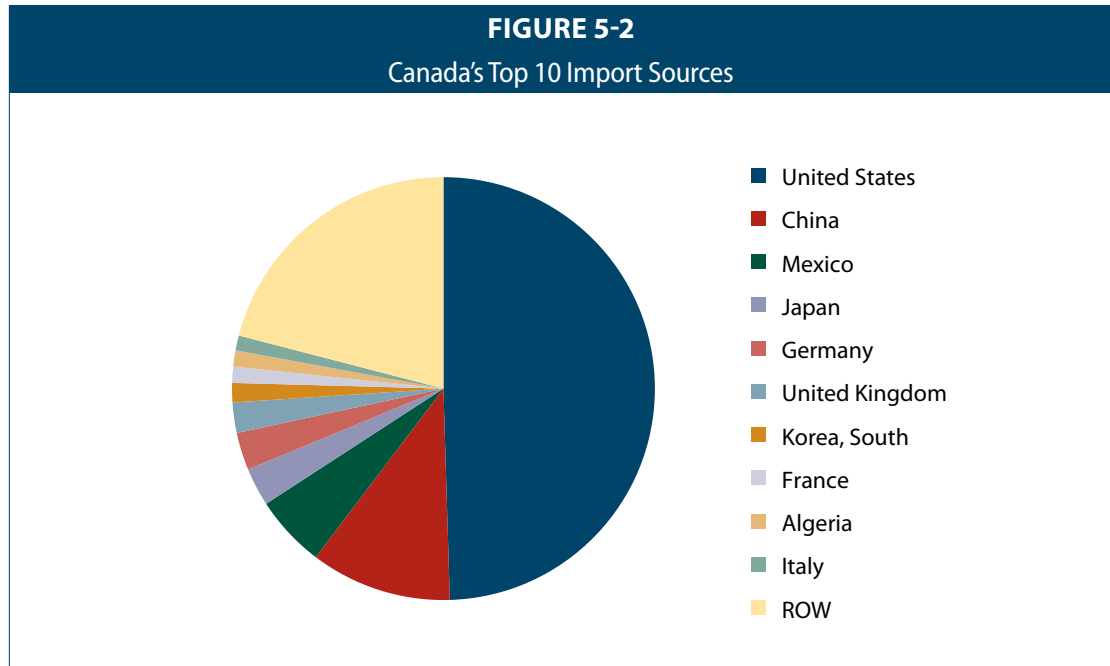
The rate of growth of Canadian merchandise imports slowed from the years 2010 and 2011 when annual growth exceeded 10 percent. In 2012, imports grew only 3.5 percent; this was nevertheless more than twice the growth rate for exports. Two factors were primarily responsible: a relatively better economic situation in Canada, and hence increased domestic demand, and an unfavourable shift in Canada's terms of trade, as the prices of Canadian exports mostly declined relative to the prices of Canadian imports. The increase in imports last year amounted to \$15.6 billion and brought the total in 2012 to \$462.1 billion—a new record high.

Canada's import sources became more concentrated in 2012: together, the top 10 accounted for 80.2 percent of Canada's imports, up from 79.1 percent in 2011. The top 20 suppliers also became more concentrated, accounting for 88.0 percent of Canada's imports, up from 87.0 percent in 2011. The composition of Canada's top 10 merchandise import sources remained stable, with the only change being France, which dropped from eighth position to tenth, below Algeria and Italy. Canada's imports from most sources grew, with three exceptions: the United Kingdom, South Korea and France.

The **United States** remained Canada's most important import supplier: its share of Canada's import market actually increased for the first time since 1998, reaching 50.6 percent. Canada's total merchandise imports from the United States rose 5.7 percent, or \$12.5 billion, to \$233.8 billion. Two import categories together accounted for half of this growth: automotive products (up \$3.6 billion or 8.7 percent) and mechanical machinery (up \$3.1 billion, or 9.6 percent). Import growth in automotive products was broad-based: imports of trucks, passenger cars and parts all grew as production in the North American automotive sector slipped into a higher gear.

Growth was more moderate in other categories, although fairly widespread: imports of articles of iron and steel increased 12.3 percent, or \$721 million; imports of medical and scientific instruments increased 10.7 percent, or \$673 million; imports of electrical machinery increased 4.0 percent, or \$566 million; and imports of plastics and articles of plastic increased 4.0 percent, or \$442 million. Increases in imports also took place in furniture (up \$324 million); meat (up \$319 million); mineral fuels and oils (up \$299 million); miscellaneous foods (up \$265 million); and chemicals (up \$244 million). By





contrast, decreases in imports took place for paper and paperboard (down \$348 million, or 7.1 percent); ores, slag and ash (down \$295 million, or 14.2 percent, mainly due to lead ores); pharmaceutical products (down \$241 million, or 5.4 percent); and iron and steel (down \$193 million, or 3.2 percent).

**China** ranked second among Canada's sources of imported merchandise in 2012, with imports from China increasing 5.3 percent, or \$2.5 billion, to reach a milestone \$50.7 billion—double that of third-ranked Mexico. China's share also increased, reaching 11.0 percent. As China's movement up the value chain continues, over two thirds of the import growth last year (\$1.7 billion) was in the two categories of electrical machinery (mostly mobile phones, up \$995 million or 8.4 percent), and mechanical machinery (predominantly laptops, up \$741 million or 7.9 percent). Together, these two categories accounted for more than 45 percent of Canada's total imports from China, outstripping all other categories by far. Imports of furniture, Canada's

third-largest import category, were also sizeable last year, up 9.1 percent, or \$246 million, to reach \$3.0 billion. The other large increase occurred in imports of automotive products (up \$243 million, or 19.8 percent), to reach \$1.5 billion in 2012. While imports of articles of iron and steel, plastic products and rubber products also experienced increases in excess of \$100 million each, imports in other categories declined substantially. Imports were down for non-knit apparel and accessories by \$172 million (down 8.1 percent); for knit apparel and accessories by \$153 million (down 7.2 percent); and for toys, games and sports equipment by \$131 million (down 4.9 percent).

**Mexico** ranked third among the top 10, with a stable 5.5-percent market share and total imports of \$25.5 billion. Imports grew 3.9 percent in 2012 (up \$946 million), slightly above Canada's overall rate of import growth. Imports of automotive products grew 9.1 percent, or \$599 million, accounting for over half of the increase. Imports increased for furniture by

\$216 million; mechanical machinery by \$189 million; and medical and scientific instruments by \$177 million. Imports of electrical machinery underwent a large \$500-million decrease (down 7.5 percent), while smaller declines occurred in imports of mineral fuels and oil (down \$238 million) and precious metals (down \$137 million).

**Japan** was the fastest-growing source of imports into Canada and retained fourth spot in the list. Recovery and rebuilding of Japan-centered supply chains raised Canadian imports from that country by \$2.0 billion, or 15.0 percent, to reach the total of \$15.0 billion in 2012. Imports of automotive products, Canada's top import article from Japan, recovered strongly, up 24.7 percent, or \$1.2 billion, during the year. Growth was the rule across the board, with notable increases in imports of mechanical machinery (up \$307 million); electrical machinery (up \$151 million); and aircraft and parts (up \$115 million). The only notable decline occurred in imports of mineral fuels and oil (down \$79 million, all refined oil).

**Germany** remained fifth among Canada's top 10 sources of merchandise imports, and, as with Japan, Canada's imports from Germany experienced strong growth, up 11.7 percent, or \$1.5 billion, to \$14.3 billion. Over a third of this increase in imports was attributable to mechanical machinery (up 24.2 percent or \$647 million); and another third to automotive products (up 14.8 percent or \$539 million). Canada's imports from Germany also increased for electrical machinery (up \$202 million); railway stock (up \$81 million); and pharmaceutical products (up \$75 million).

The imports from the **United Kingdom** experienced a large decline, but the U.K. retained its

sixth place in the rankings. Imports fell 17.3 percent, or \$1.8 billion, to \$8.5 billion—the largest decline registered for any single destination in 2012. The overall drop can be traced to the \$1.3-billion decrease in imports of mineral fuels and oil (down 47.7 percent) that came on the heels of a \$0.8-billion decline in 2011. Thus in just two years, the importance of the United Kingdom as a source of crude oil for Canada has all but waned as U.K.-sourced imports dropped from nearly \$3.0 billion to under \$1.0 billion. Significant declines also took place in imports of mechanical machinery (down 25.0 percent or \$439 million) and precious stones and metals (down 34.8 percent or \$372 million). Canada increased its imports in a few categories: automotive products (up 33.4 percent or \$208 million); and miscellaneous chemical products (up 73.4 percent or \$90 million), mostly lab reagents and herbicides.

**South Korea** was in seventh place in Canada's top 10 merchandise import sources, with the total of \$6.4 billion for the year. Imports from South Korea also fell in 2012, the decline amounting to \$242 million (down 3.7 percent). Declines in imports of electrical machinery (down \$553 million), mineral fuels and oil (down \$170 million) and mechanical machinery (down \$112 million) were nearly offset by the increase in imports of automotive products, up 30.9 percent or 605 million—all in passenger cars. Imports of iron and steel, plastics, and articles of iron and steel also increased.

**Algeria** passed France to claim the eighth position in the rankings, with \$6.0 billion in imports, up 9.1 percent, or \$0.5 billion. As in 2011, crude oil accounted for 99.9 percent of Canada's imports from Algeria, with sugar and fruit a distant second and third (\$4 million and \$1 million, respectively).

**Italy** rose to rank ninth among the top 10 in 2012, with \$5.2 billion in total import value, up 2.3 percent, or \$118 million. Imports of pharmaceuticals led the increase with a \$41-million gain, followed by mechanical machinery, up \$24 million; articles of iron and steel, up \$23 million; and beverages, up \$21 million.

**France** dropped from eighth spot to tenth as a result of a \$541-million decline in Canada's imports from France. Total imports from France were down 9.7 percent in 2012 to \$5.0 billion. Imports of aircraft and parts led the decline, down \$212 million; drops in imports also occurred for pharmaceuticals (down \$148 million); organic chemicals (down \$74 million); medical and scientific instruments (down \$65 million); and mechanical machinery (down \$62 million).

## Merchandise Trade by Top Drivers

Canada's trade performance can be examined in greater detail using a commodity breakdown comprising over 1,200 items.<sup>2</sup> However, only a few of these items account for a sufficient trade value to decisively influence Canada's trade balance. Table 5-1 lists the top 20 drivers of Canada's export and import performance in 2012 at the 4-digit HS level.

It is easier to understand the influence of Canada's top trade drivers by first considering trade balances at the 2-digit HS level. In 2012, 33 of the 98 2-digit HS commodities posted positive trade balances while 65 commodities posted negative balances, almost double the number of commodities with positive balances.

As the overall trade deficit is only \$7.7 billion, this means that, on average, commodities posting positive trade balances run much higher individual surpluses than the individual deficits for the commodities with negative trade balances. Consequently, Canada's trade balance is driven by several high-surplus items, which are mostly resources or resource-related commodities. The surplus generated in those areas offsets the smaller individual deficits among the remaining traded items (except for mechanical machinery and electrical machinery whose deficits are large), which comprise mostly manufactured goods. Focusing on the 4-digit HS commodities simply magnifies this picture, while promoting a better understanding of the nature of the traded commodities.

The 20 drivers listed in Table 5.1 together accounted for 49.3 percent of Canada's exports and 28.1 percent of its imports in 2012. The combined contribution of these 20 drivers to Canada's merchandise trade balance amounted to \$1.9 billion last year, while the overall trade balance declined by \$8.7 billion. In 2012, eight of the selected products improved their individual trade balances for a combined total of \$16.2 billion while the trade balances of the other twelve deteriorated by a combined total of \$14.3 billion. Growth in exports of these commodities was slightly above average (up 2.5 percent) while their import growth was slightly below average (up 2.8 percent).

Table 5.1 divides these top drivers into two broad categories: fifteen trade surplus commodities and five trade deficit commodities. These are further subdivided into commodities

<sup>2</sup> Canada's merchandise trade is most commonly reported using the Harmonized System (HS) of Trade Classification, an international system for codifying traded commodities. Within the HS system, trade is classified into 98 chapters, also known as the 2-digit HS level. Commodities in each chapter are further subdivided into 4-, 6- and 8-digit HS levels, with international comparisons possible down to the 6-digit HS level. This section examines those commodities (expressed at the 4-digit HS level) that drove the change in Canada's trade balance during the past year.

TABLE 5.1						
Canadian Merchandise Trade by Top Drivers						
(\$ millions and %)						
Commodity	2012 Exports	Export Growth	2012 Imports	Import Growth	Balance 2012	Δ Balance 2012/2011
	\$	%	\$	%	\$	\$
<b>TRADE SURPLUS PRODUCTS</b>						
<b>Large Exports and Large Imports</b>						
Passenger Cars	46,889.7	19.1	25,908.5	11.1	20,981.3	4,915.2
Crude Oil	74,362.0	8.1	29,890.1	3.4	44,471.9	4,577.9
Oil (not Crude)	19,672.3	13.7	15,346.4	-6.5	4,322.5	3,425.4
Radioactive Chemical Elements and Isotopes	1,757.6	-35.0	926.4	-9.8	831.1	-847.3
Gold	15,321.0	-8.9	9,800.6	-2.9	5,520.4	-1,205.9
Petroleum Gases	11,214.1	-32.0	3,579.6	-28.0	7,634.6	-3,873.5
<i>Subtotal</i>	<b>169,216.7</b>	<b>4.8</b>	<b>85,451.6</b>	<b>0.9</b>	<b>83,765.1</b>	<b>6,991.8</b>
<b>Large Exports and Small Imports</b>						
Soybeans	2,168.6	51.7	157.8	7.5	2,010.7	727.7
Canola Seeds	5,210.6	13.4	141.0	30.3	5,069.6	583.9
Sawn and Chipped Wood	5,921.8	10.2	478.6	9.9	5,443.2	506.0
Nickel, Unwrought	2,373.7	-20.3	13.2	-36.8	2,360.5	-598.5
Potash	6,073.3	-9.7	35.7	33.4	6,037.6	-659.2
Intermediate Nickel Products	2,449.0	-23.3	97.1	53.5	2,351.9	-776.2
Chemical Woodpulp, Soda or Sulfate	4,358.5	-16.4	168.4	6.9	4,190.2	-863.8
Aluminum, Unwrought	5,446.4	-14.9	322.6	-5.5	5,123.8	-932.4
Coal	6,325.8	-21.0	1,006.1	4.6	5,319.7	-1,729.0
<i>Subtotal</i>	<b>40,327.8</b>	<b>-8.2</b>	<b>2,420.5</b>	<b>7.0</b>	<b>37,907.3</b>	<b>-3,741.6</b>
<b>TRADE DEFICIT PRODUCTS</b>						
<b>Large Exports and Large Imports</b>						
Industrial Machinery, Various	1,418.5	19.4	1,558.7	-29.4	-140.2	878.7
Precious Metal Wastes and Scraps	1,154.9	2.9	1,868.0	-22.2	-713.1	564.6
Motor Vehicle Parts	10,110.1	9.0	21,498.0	11.9	-11,387.9	-1,447.2
<i>Subtotal</i>	<b>12,683.5</b>	<b>9.5</b>	<b>24,924.7</b>	<b>4.6</b>	<b>-12,241.2</b>	<b>-3.7</b>
<b>Small Exports and Large Imports</b>						
Tractors	437.3	7.8	4,109.0	18.4	-3,671.7	-606.6
Transport Vehicles	1,118.8	16.6	13,087.2	7.5	-11,968.5	-752.9
<i>Subtotal</i>	<b>1,556.1</b>	<b>14.0</b>	<b>17,196.2</b>	<b>9.9</b>	<b>-15,640.2</b>	<b>-1,359.5</b>
<b>20 Product Total</b>	<b>223,784.1</b>	<b>2.5</b>	<b>129,993.0</b>	<b>2.8</b>	<b>93,791.1</b>	<b>1,887.1</b>
<b>Total All Commodities</b>	<b>454,377.0</b>	<b>1.5</b>	<b>462,058.7</b>	<b>3.5</b>	<b>-7,681.7</b>	<b>-8,741.3</b>

with substantial trade flows in both directions and commodities where trade is essentially a one-way street.

Trade surplus commodities that exhibited substantial two-way flows were represented by passenger cars, crude oil, non-crude oil, radioactive chemical elements and isotopes, gold and petroleum gases. Passenger cars are one of the mainstays of Canada's trade with the United States: large two-way flows of finished products are driven by economies of scale and preferences for variety. This commodity made the biggest positive contribution to Canada's trade balance, with a \$4.9-billion gain in trade surplus that reached \$21.0 billion as growth in exports (up 19.1 percent) outpaced growth in imports (up 11.1 percent). Trade in crude oil made second-biggest contribution of \$4.6 billion to the overall trade balance; the surplus for this commodity reached \$44.5 billion last year. Non-crude oil also made a large positive contribution of \$3.4 billion as exports rose and imports sank. The overall effect of these big three surplus drivers was a positive \$12.9 billion contribution to the trade balance; however, the other three commodities from this section made negative contributions. Exports of petroleum gases continued to shrink in value (down 32.0 percent), and although imports also fell (down 28.0 percent), the latter were much smaller. The combined effect was a \$3.9-billion deterioration of the trade balance in petroleum gases, which reduced the surplus in this commodity to \$7.6 billion in 2012. The decrease in gold exports reduced the surplus in that category by \$1.2 billion while the loss of a third of exports of radioactive chemical elements and isotopes caused a corresponding \$0.8-billion reduction in that surplus. Overall, these six items made a positive contribution to the trade balance of \$7.0 billion.

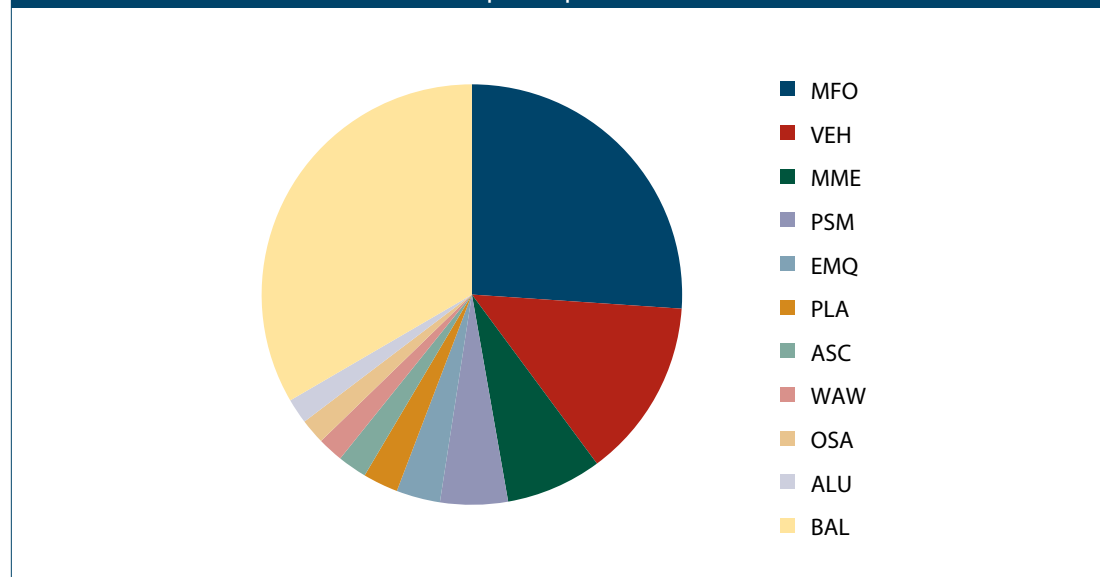
Export items for which import flows were small mainly consisted of resources: soybeans, canola seeds, wood, nickel, potash, coal and aluminum. Most of the export prices for these resources stalled or weakened in 2012, leading to a general deterioration in Canada's trade balance from this group. Coal balances experienced the biggest hit, declining \$1.7 billion. Overall, these nine commodities contributed a negative \$3.7 billion to Canada's trade balance.

On the other side of the balance sheet, the three products in which strong two-way trade resulted in deficits in 2012 comprised motor vehicle parts, precious metal wastes and scrap, and various industrial machinery. The latter two actually contributed positively to Canada's trade balance in 2012. Imports of various industrial machinery dropped nearly 30.0 percent, while exports increased nearly 20.0 percent, which improved the trade balance by \$0.9 billion and in the process almost wiped out the deficit for this item. Imports of precious metal wastes and scrap also decreased, improving the balance in that category by \$0.6 billion. Offsetting these improvements was the \$1.4-billion deterioration of the trade balance in motor vehicle parts, as imports grew faster than exports. Thus, the combined effect of these three products on the trade balance was insignificant.

Tractors and transport vehicles (mainly trucks) are the only two products for which Canada records large imports and small exports. These products contributed negative amounts of \$0.6 billion and \$0.8 billion, respectively, to Canada's trade surplus, as a large expansion in imports overshadowed export growth. Together, the deficit for these two items widened by \$1.4 billion to reach \$15.6 billion.

FIGURE 5-3

Canada's Top 10 Export Commodities



MFO=Mineral fuels and oil; VEH=Vehicles and parts; MME=Mechanical machinery and equipment; PSM=Precious stones and metals; EMQ=Electrical machinery and equipment; PLA=Plastics and articles thereof; ASC=Aircraft, spacecraft and parts; WAW=Wood and articles of wood; OSA=Ores, slag and ash; ALU=Aluminum and articles thereof; BAL=All other commodities

## Merchandise Trade by Major Product Groups

This section discusses Canada's 2012 trade performance by commodity groupings that are an aggregated version of the 2-digit level HS chapters. These major groups, 12 in all, are defined as follows: energy; vehicles and parts; mechanical machinery and appliances; electrical and electronic machinery; technical and scientific equipment; agricultural and agri-food products; metals and minerals; chemicals, plastics and rubber products; wood, pulp and paper; textiles, clothing and leather; consumer goods and miscellaneous manufactured products; and other transportation equipment. The first five of these groups are single 2-digit HS chapters, while each of the remaining seven combine several chapters. Together, they encompass all of Canada's merchandise trade by the 98 HS chapters.

## Energy Products<sup>3</sup>

Canada's exports of energy products grew 1.0 percent, or \$1.1 billion, to reach \$115.8 billion in 2012. Exports of energy products, one of the key components of Canada's trade, accounted for just over a quarter of all Canadian merchandise exports. The moderate export growth was a combination of many factors: crude oil prices remained stable overall for the year, and a small increase in export volumes took place; non-crude oil prices increased by 5 percent and export volumes increased by 8 percent; however, this growth was offset by the fall in the price of petroleum gases (down more than 30 percent) and of coal (down more than 20 percent). Imports of energy products declined 3.1 percent, or \$1.6 billion, to \$51.4 billion in 2012. As a result, the overall trade surplus in energy products expanded again last year, by \$2.8 billion, to reach \$64.4 billion. In practice,

<sup>3</sup> HS Chapter 27.

## The Impact of Energy on Canadian and Mexican Exports to the United States

*Terry Cowl & Marybeth Mitchell - GGA*

### Introduction—the rise of energy

Despite a recent trend in Canada and Mexico toward diversifying their export markets overseas, both of these economies remain highly dependent on the U.S. market as their primary export destination. Although the percentage of Canada's exports to the United States has declined over the past 15 years—from almost 85 percent of merchandise exports in 1998—shipments to the U.S. market still accounted for almost three quarters (74.5 percent) of all Canadian merchandise exports in 2012.<sup>1</sup> Mexico has displayed a similar trend, with 87.6 percent of its merchandise exports bound for the United States in 1998, which gradually declined to 77.6 percent in 2012.

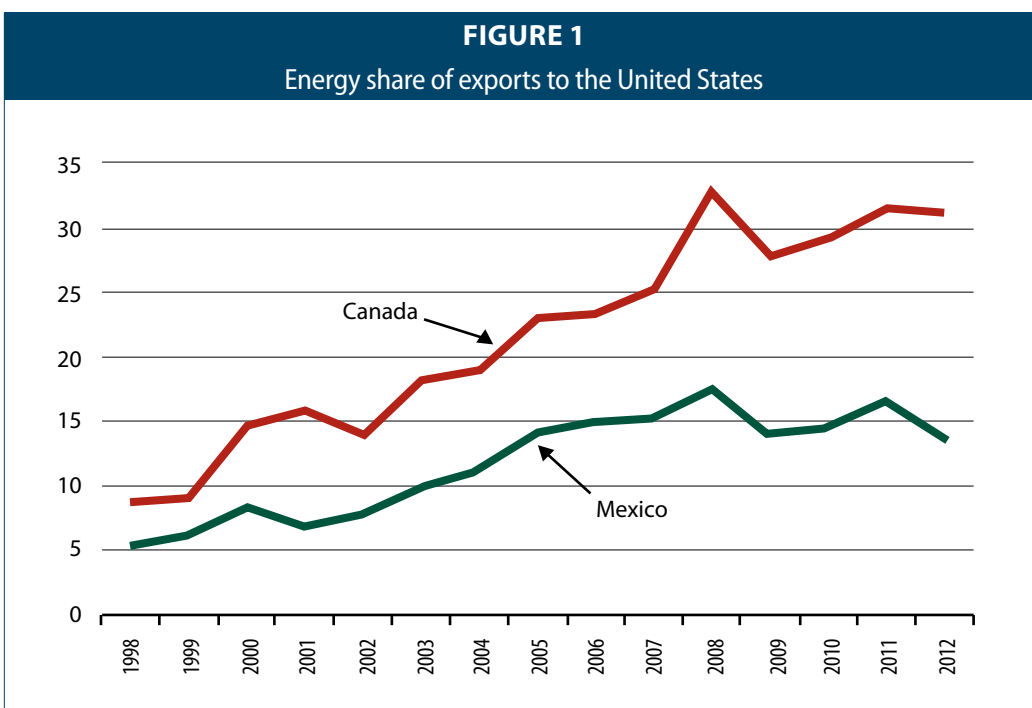
Yet both Canada and Mexico have witnessed a dramatic change in export patterns to the United States over this 15-year period: the notable rise of energy as a dominant export to the U.S. market. The trend has been starker in Canada's case, as energy (HS 27) accounted for just under 9 percent of Canadian merchandise exports to the United States in 1998, climbing steadily until it comprised a full third of Canadian exports in the pre-recession year of 2008, followed by a brief dip and then a return to over 31 percent in both 2011 and 2012. In 2005, energy surpassed automotive exports as Canada's number one U.S.-bound merchandise export. Crude oil was the dominant component of these energy exports, accounting for almost 70 percent of U.S.-bound energy shipments last year (up from just under 37 percent in 1998).

In the case of Mexico, the trend is somewhat similar, but much less pronounced. Energy shipments accounted for 5.4 percent of exports to the United States in 1998 and climbed steadily to a peak of 17.7 percent in 2008, but then declined to 13.7 percent in 2012.<sup>2</sup> Crude oil also made up the dominant portion of Mexican energy shipments during this period, comprising between 84 percent to 92 percent of all energy exports to the United States during the 1998-2012 period. But, unlike in Canada, energy did not become the top export product during this time. It was ranked as high as second (behind electrical machinery) in both 2007 and 2008, but was fourth in 2012.

1 This share changes when discussing goods and services trade data (via balance of payments) as exports to the U.S. comprised 85.5 percent of all Canadian shipments in 1998, compared to 65.8 percent in 2012. Of course, Balance of Payments data does not currently provide the detailed sectoral breakdown compared to merchandise trade data.

2 This recent decline is a result of Mexico's decreasing oil production: according to the U.S. Energy Information Administration, Mexico's oil production has steadily declined since the mid-2000s.





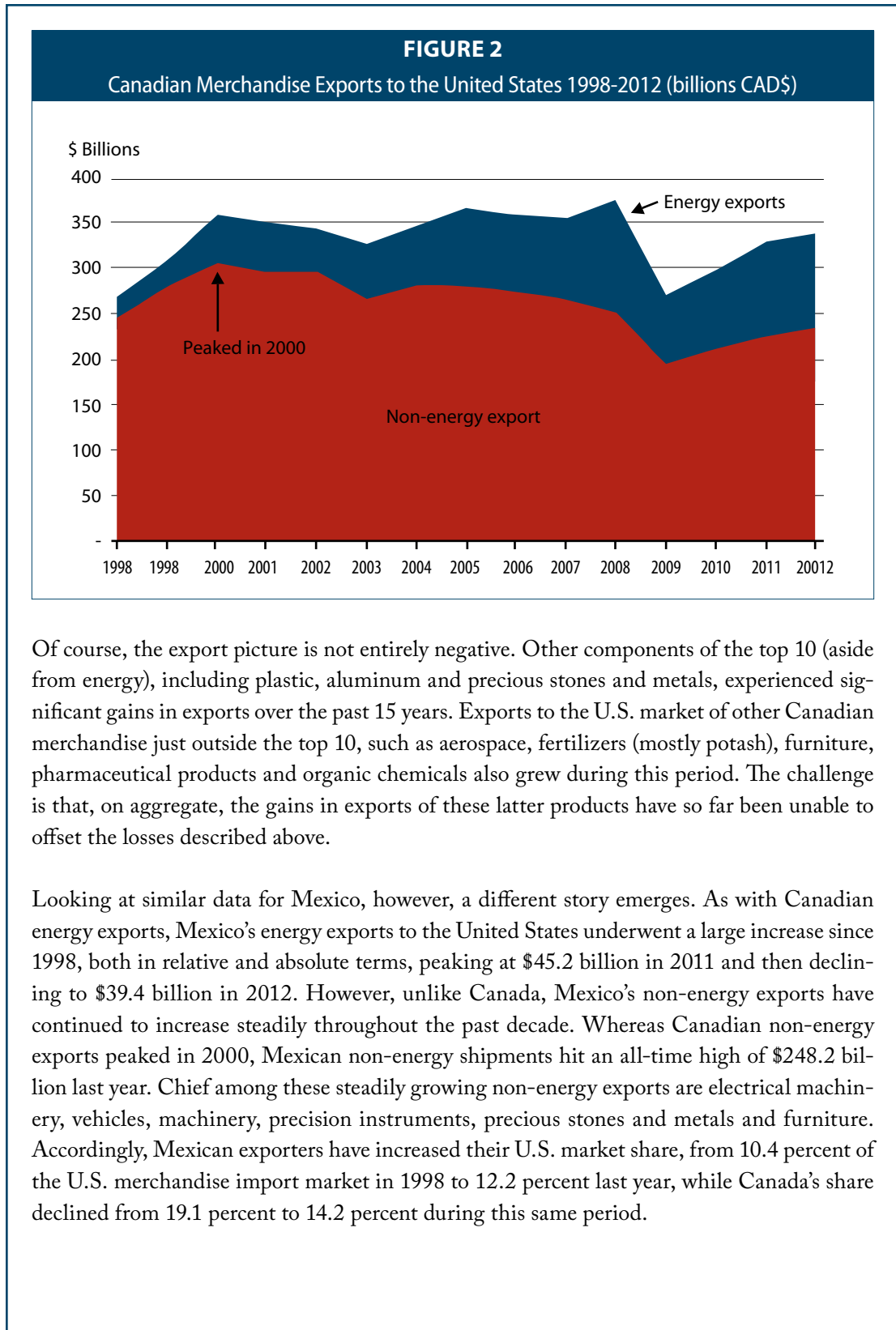
### What happened to the rest?

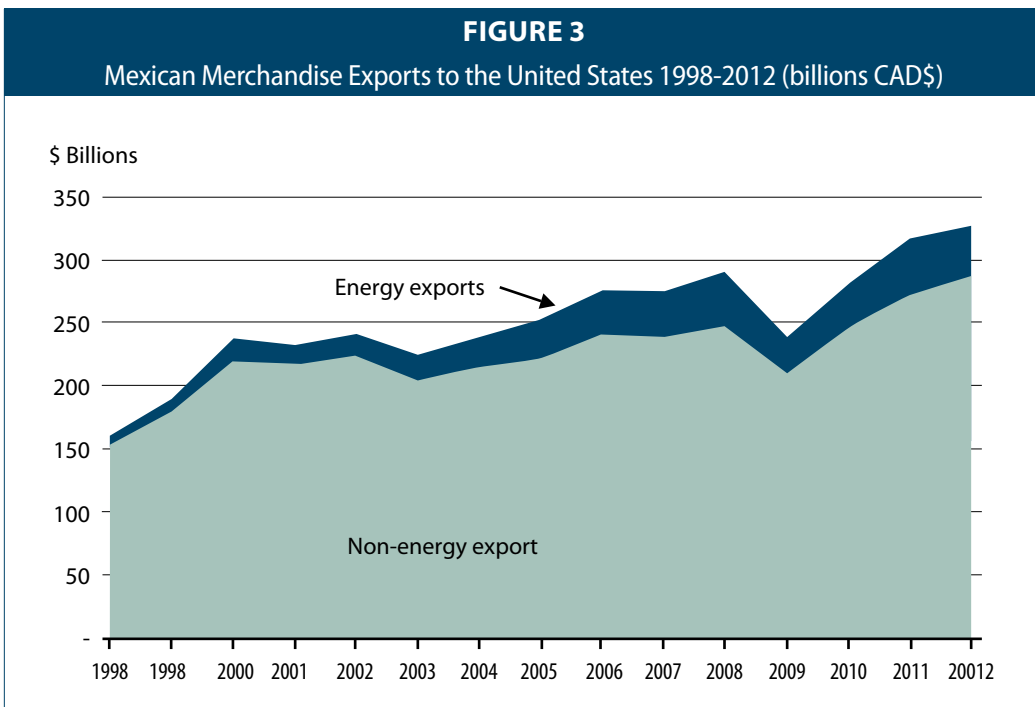
Concurrent with the rise of energy as Canada's dominant export commodity over the past decade and a half has been the relative—and absolute—decline of Canada's non-energy shipments to the United States. In 1998, Canada's non-energy exports to the U.S. market were valued at \$246.2 billion, climbing to a peak of \$306.5 billion just two years later, in 2000. The value of energy exports has steadily declined since that period, reaching \$232.9 billion last year, which translates to a compounded annual growth rate (CAGR) of minus 0.4 percent over the 1998-2012 period.

On a sectoral basis, of the remaining top 10 merchandise exports to the United States in 2012 (with energy as number one), six of the nine categories had experienced absolute declines in exports between 1998 and 2012. The following export categories represent this declining trend during the period:

- automotive—from \$68.2 billion in 1998 to \$58.4 billion in 2012 (CAGR of -1.1 percent);<sup>3</sup>
- machinery—from \$26.5 billion to \$23.1 billion (CAGR of -1.0 percent);
- electrical machinery—\$15.8 billion to \$10.6 billion (CAGR of -2.8 percent); and
- wood—from \$14.9 billion to \$6.6 billion (CAGR of -5.6 percent).

<sup>3</sup> The struggling automotive sector may, however, be taking a turn for the better, as Canadian automotive exports to the United States rebounded significantly in 2012, up 16.2 percent from the previous year. However, it would be premature to suggest this trend will continue.





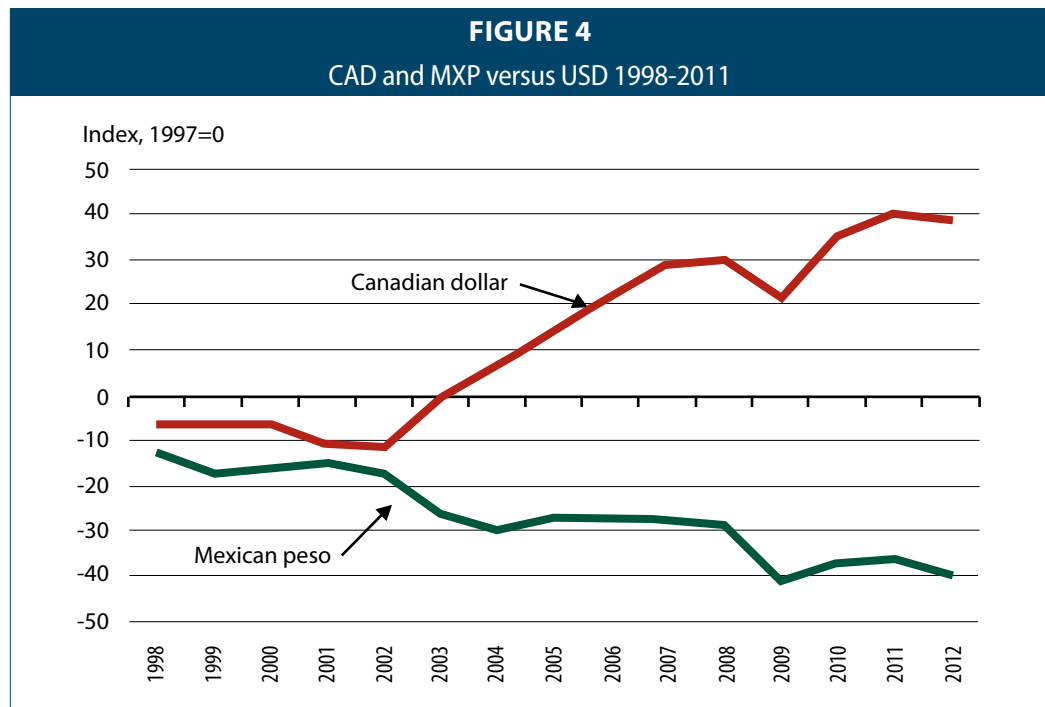
There are several possible explanations for these divergent trends. First, as previously mentioned, Mexico's oil exports to the U.S. have not been increasing to the same extent in recent years as Canada's oil exports, which rose 121 percent from 2005 to 2012 versus 57 percent for Mexico,<sup>4</sup> and although Mexican oil exports reached a high in 2011, oil production in Mexico has actually stagnated since 2009 and is expected to decline in the medium term.<sup>5</sup> While recent reforms in the Mexican energy sector may increase investment and technology upgrades, Mexico—due to prohibitions by the Mexican constitution on foreign investment in the petroleum sector—is not seeing the same large investment inflows into the oil sector that are occurring in Canada. As a result, the energy sector is less dominant in Mexico's export profile than Canada's.

On the non-energy side, as Mexico is an emerging economy, exporters have been able to benefit from ongoing liberalization and modernization, resulting in faster export growth than in developed economies such as Canada. The Mexican economy has also benefited from the recent “re-sourcing” trend with some North American firms moving Asian manufacturing platforms back home due to rising labour costs in Asia. Mexico, with its close proximity to the U.S. market, is particularly well placed to benefit from this trend, having much lower labour costs than Canada and the United States—and in some cases even lower than those in Asia.<sup>6</sup>

4 Oil exports classified as HS 2709 + 2710

5 Mexico Overview, U.S. Energy Information Administration

6 An April 2013 study by Bank of America Merrill Lynch stated that Mexico's hourly wages are about one fifth lower than China's, a huge turnaround from just 10 years ago when they were nearly three times higher.



Source: World Bank and Bank of Canada

Concurrently, underpinned by FDI from the United States, Japan and Germany, Mexican productive capacity in the automotive sector has increased significantly, leading to a rise in automotive exports from Mexico to the United States. Automotive exports account for one quarter of all Mexican manufacturing exports to the United States.<sup>7</sup>

Another significant factor behind these divergent trends is the changing export competitiveness of Mexican and Canadian goods in the United States due to currency valuations. As Figure 4 shows, the Mexican peso depreciated almost 40 percent from 1997 to 2012 versus the U.S. dollar, while the loonie appreciated over 38 percent relative to the U.S. dollar during this same time period.<sup>8</sup> The different trajectories of these two currencies was partly due to the greater increase in oil production (and oil exports) in Canada. As a result, over this period, Canadian exports have become more expensive (and less cost-competitive) relative to goods and services produced domestically in the United States or imported from Mexico.

### Conclusion

Mexico’s continued liberalization, modernization and economic growth is likely to promote its manufacturing exports to the United States, while its energy exports diminish in

<sup>7</sup> “The Comeback”, Herman Kamil and Jeremy Zook, *Finance and Development*, March 2013.

<sup>8</sup> As a rule, economies with consistently lower inflation rates (e.g. Canada) experience a rising currency value as their purchasing power increases relative to other currencies. For Mexico during this period, the inverse was true.

importance. Canada, on the other hand, will likely see energy remain as its top export to the United States as investment in this sector remains strong; however, energy does not have to crowd out other exports. Just as with Mexico, Canada could be well placed to take advantage of any “re-sourcing” of manufacturing back to North America by focusing on the Canadian advantages of high-skilled labour, a well-educated work force and a high degree of economic integration with its neighbor to the immediate south. In the end, bilateral trade patterns on the continent will continue to evolve, sometimes in opposite directions, but what will remain constant is that for both Canada and Mexico, a large portion of their trade will depend on the United States. ■

the surplus in energy exports covers Canada's deficit in many other import categories; for example, it roughly balances the combined deficit in both mechanical and electrical machinery groups, the two biggest deficit items on the deficit list.

The United States remained the principal destination for Canada's energy exports and in 2012 accounted for 91.4 percent of these exports; the value of Canada's energy exports to the United States totalled \$105.8 billion last year, following growth of only 1.6 percent. The crude oil share of energy exports to the United States has been growing over the years and reached nearly 70 percent in 2012. The share of non-crude oil has remained roughly stable, at 15.7 percent, while the share of petroleum gases (largely natural gas) has sharply declined from over 20 percent in 2010 to just above 10 percent in 2012. Imports of energy products from the United States grew at a similar pace last year (up 1.8 percent) but the value of imports was much smaller overall (\$17.4 billion)—with non-crude oil constituting over half of these imports—and resulted in a \$88.4-billion trade surplus, which was \$1.4 billion higher than in 2011. The share of petroleum gases declined to 19.4 percent in 2012 while the crude oil share increased to 13.4 percent in 2012.

Canada's energy exports to destinations other than the United States were valued at only \$10 billion in 2012, with those flows undergoing some important changes. Exports to China, the second-largest destination, increased by 59.2 percent, as coal exports nearly doubled. By contrast, exports to the next top three destinations all decreased in value: to Japan by 15.2 percent; to the Netherlands by 7.7 percent; and to South Korea by 40.6 percent. All of these

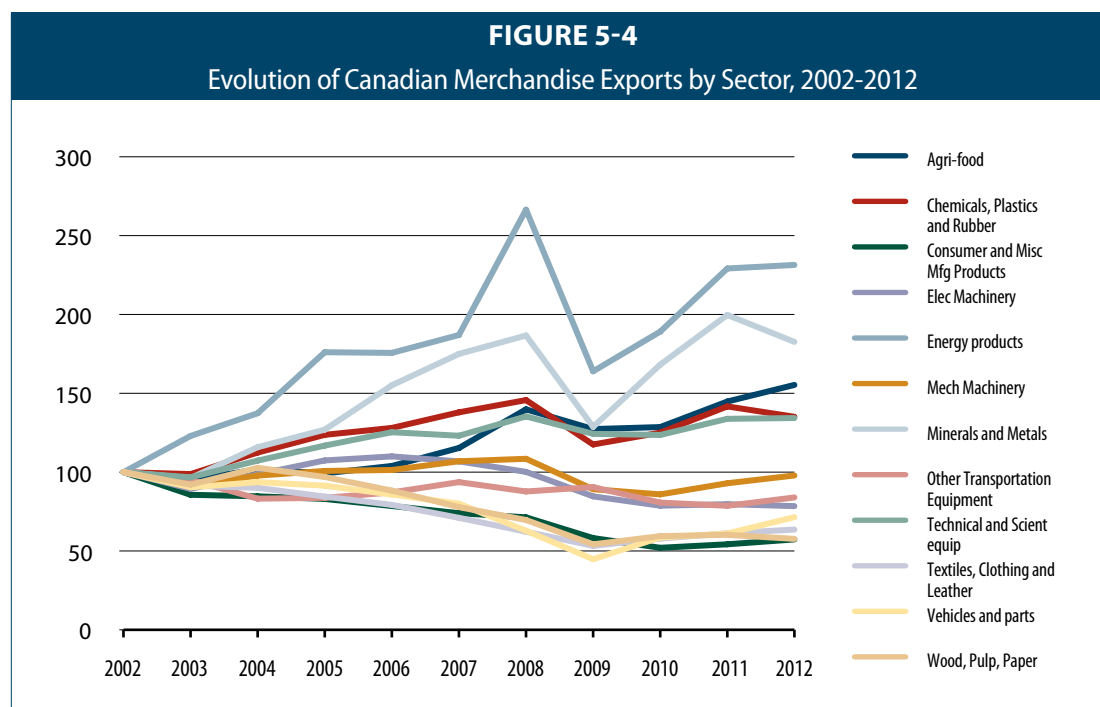
decreases were either largely or entirely due to decreased exports of coal. Shipments of refined oil to France and the United Kingdom more than doubled energy exports to those countries, and likewise increased shipments of refined oil increased exports to Bahamas from \$100 million to \$459 million.

It is noteworthy that Canada has generally exported crude oil to only two destinations—the United States and China—but that changed in 2012 when the United Kingdom made the list as the third-most important destination, receiving crude oil exports from Canada worth \$200 million. Canada continued to only export petroleum gases to the United States.

Canada's sources of imported energy products were more varied geographically than its export destinations. In 2012, twelve countries contributed over \$1 billion in shipments of energy products to Canada. Just over a third came from the United States (\$17.4 billion); Algeria ranked second (\$6.0 billion); and Iraq ranked third (\$4.0 billion). Other major suppliers included Norway, Kazakhstan, Saudi Arabia, the Netherlands, Nigeria, Angola, the United Kingdom and, for the first time, Azerbaijan. Energy imports from Russia and Venezuela continued to contract last year, to \$410 million and \$205 million, respectively.

Compositionally, Canada's energy exports are increasingly dominated by crude oil<sup>4</sup> (64.2-percent share in 2012, up from 54.9 percent in 2010, followed by non-crude oil at 17.0 percent and petroleum gases plummeting to 9.7 percent in 2012 from 19.4 percent in 2010. Coal, the only other significant export product, held a 5.5-percent share. On the import side, crude oil accounted for 58.1 percent of the

4 HS 2709.



total, non-crude for 29.9 percent and petroleum gases for 7.0 percent. As noted above, in 2012, Canada exported crude oil only to the United States (\$73.7 billion, or 99.2 percent of the total), to China (\$435 million) and to the United Kingdom (\$200 million), but its import suppliers were considerably more varied: all of the energy product sources mentioned above mostly supplied crude oil (with the exception of the Netherlands, which supplied non-crude). Exports of crude oil grew 8.1 percent overall to \$74.4 billion, while imports expanded 3.4 percent to \$29.9 billion, which raised the crude oil trade balance by 11.5 percent over 2011 to \$44.5 billion. The export price of Canada's crude oil was on average the same as in 2011; import prices generally increased, further worsening Canada's terms of trade in crude oil (see the *Diverging Crude Oil Prices in North America* box in Canada's State of Trade 2012).

Exports of non-crude oil<sup>5</sup> were up 13.7 percent in 2012, or \$2.4 billion, to \$19.7 billion. Over two thirds of the gains were accounted for by increased exports to the United States, which grew 11.2 percent, or \$1.7 billion, to \$16.6 billion; increased shipments to France and the Bahamas accounted for most of the remainder. Meanwhile, Canada's non-crude imports retreated from their 2011 high of \$16.4 billion, dropping 6.5 percent to \$15.3 billion. Imports from the United States expanded further (up 10.3 percent to \$9.4 billion), and imports from the Netherlands doubled to \$2.1 billion, while shipments from most of Canada's other suppliers declined (e.g., the United Kingdom, Mexico, Spain, Finland, Norway and Singapore). These changes have considerably improved Canada's non-crude oil trade balance: from \$900 million in 2011 to \$4.3 billion in 2012.

5 HS 2710.



Exports of petroleum gases,<sup>6</sup> destined exclusively for the United States, decreased over 30 percent in price and 32.0 percent in value to end at \$11.2 billion. Imports contracted likewise, down 28.0 percent to \$3.6 billion in 2012. Some 94.4 percent of these imports came from the United States and 3.8 percent came from Qatar. The resulting negative effect on the trade balance was \$3.9 billion, the largest deterioration for any single 4-digit HS commodity in 2012.

Declining coal prices meant that exports of coal<sup>7</sup> also fell from their 2011 high, down 21.0 percent to \$6.3 billion. The declines to Japan, South Korea and Brazil contributed to this fall, despite the expansion of coal exports to China. Coal imports totalled \$1.0 billion, mostly from the United States. The net result was a trade balance of \$5.3 billion, down \$1.7 billion in 2012, the second-biggest decline after petroleum gases.

### Vehicles and Parts<sup>8</sup>

The growing bilateral trade between Canada and the United States provides evidence of a strong recovery in the North American automotive sector. Growth in exports of vehicles and parts was 17.0 percent in 2012, or \$8.9 billion. Total exports were \$61.2 billion, while total imports reached \$70.7 billion after increasing 11.2 percent (up \$7.1 billion). The trade deficit in vehicles and parts shrank by \$1.8 billion to \$9.5 billion.

The United States was the destination for most (95.4 percent) of Canada's exports in this sector and the source of nearly two thirds of Canada's imports in the sector. Exports to the U.S. market

grew by 16.2 percent, while imports expanded by 8.7 percent. Mexico, Japan, Germany, South Korea and China were the other major suppliers of vehicles and parts to Canada, with imports above \$1 billion each, and all of these grew faster than the imports from the United States. Canada mainly imported passenger vehicles from these countries, although imports from Mexico were split evenly with trucks, and imports from China consisted mostly of motor vehicle parts. Imports from Japan recovered from their decline and increased 24.7 percent in value last year; imports from Germany, South Korea, China and the United Kingdom all increased by double-digit figures.

Of the three main product categories—passenger cars, transportation vehicles (i.e. trucks) and motor vehicle parts—passenger cars and motor vehicle parts together account for over 90 percent of Canada's automotive sector exports, with truck exports accounting for the remainder (just \$1.1 billion in 2012). Passenger car exports soared to \$46.9 billion last year (76.6 percent of automotive exports), up 19.1 percent or \$7.5 billion, with the United States accounting for the increase. Car exports to Libya also jumped, from \$9 million to \$92 million (making Libya Canada's third-ranked destination for Canadian passenger cars exports).

Exports of motor vehicle parts and accessories grew 9.0 percent last year, gaining \$0.8 billion to end at \$10.1 billion for the year (16.5 percent of all automotive exports). Most of these exports went to the United States.

On the import side, the share of the three main categories was distributed more evenly.

6 HS 2711.

7 HS 2701.

8 HS Chapter 87.

Passenger cars accounted for 36.7 percent, parts and accessories for 30.2 percent, and trucks for 18.5 percent of imports. Passenger car imports grew 11.1 percent, or \$2.6 billion, to reach \$25.9 billion. Imports grew fastest from South Korea (up 35.5 percent) followed by Japan (up 18.6 percent), while the United States contributed significantly as well with 7.4-percent growth. Imports of parts and accessories increased by 11.9 percent (a \$2.3-billion gain) to \$21.5 billion. Greater imports from Japan (up 39.5 percent) and the United States (up 8.1 percent) contributed the most to that increase. Truck imports grew 7.5 percent in 2012 to reach \$13.1 billion, evenly divided between the main sources, the United States and Mexico.

The improvement of the trade balance in passenger cars (up \$4.9 billion) was the largest single-product improvement in 2012; it was partly offset by the \$1.4-billion deterioration in the parts trade balance and the \$0.8-billion deterioration in the trucks trade balance.

### **Mechanical Machinery and Appliances<sup>9</sup>**

Mechanical machinery and appliances (hereafter referred to as “machinery”) represents one of the largest single chapters in the HS classification system, one of the “Big 3” chapters that collectively account for over a third of all international trade. In Canada’s trade, it is the third-largest category (after mineral fuels and vehicles) and is extremely varied, comprising every piece of mechanical equipment—from nuclear reactors, to engines, to pumps and valves.

Canada’s machinery exports continued recovering in 2012, gaining \$1.7 billion, or 5.3 percent,

for the total of \$32.8 billion. Exports to the United States grew \$0.9 billion, accounting for just over half of the total growth. Double-digit growth took place in machinery exports to France, Australia, Mexico, Brazil, Singapore and South Korea, although the value of each of these increases did not exceed \$0.1 billion. Turbojets, turbopropellers and other gas turbines<sup>10</sup> (mainly aircraft engines) remained the main export subcategory, growing 4.3 percent (up \$0.2 billion) to \$4.5 billion. Exports of spark-ignition engines, machinery parts, individual-function machines and moulding boxes for metal foundry grew \$0.2 billion while exports of automatic data processing machines (computers) decreased \$0.2 billion.

Canada’s machinery imports lost first place to vehicles imports in 2012, as 6.0-percent growth in this category added \$3.8 billion to the total of \$67.5 billion. Growth of imports from the top two suppliers—United States and China—was above average, while growth of imports from Mexico was slightly below average. Machinery imports from Germany picked up 24.2 percent, while those from the United Kingdom lost 25.0 percent, and imports from Taiwan were down 27.6 percent. Those losses were mitigated by growth in imports from the top suppliers. Subcategories that underwent large increases were taps, cocks, valves for pipes and tanks (up 15.7 percent); spark-ignition engines (up 15.3 percent); and bulldozers and scrapers (up 13.1 percent).

The increase in imports was proportional to exports, but as the increase in imports in absolute value terms exceeded the increase in exports by far, Canada’s trade in machinery continued to generate the biggest trade deficit

<sup>9</sup> HS Chapter 84.

<sup>10</sup> HS 8411.

of all categories: \$34.7 billion last year, which was up 6.7 percent, or \$2.2 billion. Deficits expanded with all of Canada's suppliers, particularly with the United States (up 21.4 percent) and Germany (up 30.4 percent).

### **Electrical and Electronic Machinery and Equipment <sup>11</sup>**

Exports of electrical and electronic products decreased slightly in 2012, losing \$0.2 billion (1.6 percent) to end at \$15.0 billion, a level last seen in 2010. After muted 1.3-percent growth, exports to the United States reached \$10.6 billion, or 70.4 percent of the total. Canada's other top export destinations—Mexico, the United Kingdom and China—all experienced export reductions, particularly sharp for Mexico at 40.0 percent (down \$0.3 billion). Increases in exports to France and Germany mitigated, but did not offset, these declines. Canada's exports to Hungary, which nearly tripled in 2011, declined 45.2 percent in 2012. Among the subcategories, only transmission apparatus and cameras grew (up 5.4 percent, or \$60 million) while exports of telephone equipment contracted 6.6 percent, and exports of electronic integrated circuits declined 10.7 percent.

Imports of electrical and electronic products grew even less, at 0.7 percent, or \$0.3 billion, to reach \$45.4 billion in 2012. A decrease in imports from Mexico (down \$0.5 billion), Taiwan (down \$0.2 billion) and South Korea (down \$0.6 billion) offset larger growth in imports from the United States (up \$0.6 billion) and China (\$1.0 billion). Imports from Germany and Japan also experienced robust growth. The biggest gain among subcategories occurred for cable and wire imports, which grew \$0.3 billion, and electrical boards

and panels, also adding \$0.3 billion in value. Declines occurred in imports of electronic integrated circuits (down \$0.6 billion) and of TV receivers, monitors and projectors (down \$0.3 million).

These developments meant that the trade balance for electrical and electronic products deteriorated slightly, with the deficit growing by \$0.6 billion last year to \$30.4 billion.

### **Technical and Scientific Equipment<sup>12</sup>**

Also known as precision instruments, the category of technical and scientific equipment comprises accurate high-technology devices used in sciences, research, medicine, photography and geology. Exports of this equipment were unchanged at \$5.9 billion in 2012. Exports to the United States and China grew, by 2.3 percent and 12.4 percent, respectively, but were offset by declines in exports to the United Kingdom, Germany and Italy. By subcategory, the most notable changes took place in various measuring and checking instruments (up \$68 million); liquid crystal devices and lasers (down \$73 million); and instruments and apparatus for physical or chemical analysis (down \$53 million).

Imports of technical and scientific equipment grew 7.8 percent, the same rate as last year, and advanced \$1.0 billion to \$13.5 billion in 2012. The United States was the source for half of the imports and was responsible for most of the growth, with imports increasing 10.7 percent (up \$0.7 billion). Imports from Mexico also grew by a robust 25.5 percent (up \$0.2 billion). Imports from China edged down slightly (2.7 percent), and imports from France

11 HS Chapter 85.

12 HS Chapter 90.

fell 17.5 percent. Imports of medical, surgical and dental equipment expanded \$0.2 billion, as did imports of automatic regulating or control instruments; smaller increases occurred in orthopedic appliances and artificial body parts, and instruments and apparatus for physical or chemical analysis.

As exports remained stable and imports expanded, the trade deficit for technical and scientific equipment widened by \$1.0 billion in 2012 to reach \$7.6 billion.

### **Agricultural and Agri-food Products<sup>13</sup>**

This category is one of the mainstays of Canada's exports and its trade balance. Exports of agricultural and agri-food products expanded by 7.3 percent (up \$3.2 billion) in 2012, reaching a new peak of \$47.4 billion. Prices played much less of a role in this expansion than in 2011, as most food prices moderated—in particular, the price of wheat remained at 2011 levels. Oil seeds and miscellaneous grains (canola seeds) surpassed wheat as Canada's primary export in this category, with \$8.4 billion in exports. The \$1.6-billion increase in this subcategory (up 23.7 percent, mostly to China) accounted for almost half of the total rise in the category. Wheat exports grew 7.7 percent, adding \$0.5 billion to total exports, and the other large increase occurred in the animal feed sub-category (up \$0.5 billion, or 30.5 percent). Exports of edible vegetables contracted 12.8 percent (down \$0.5 billion), and meat exports fell 3.1 percent (down \$0.1 billion). The expansion of animal and vegetable oils (predominantly canola oil) slowed to 7.7 percent, with gains of only \$0.2 billion on the year. Country-wise, most of the increase came from an 81.2-percent

expansion of exports to China (up \$2.3 billion), as China increased its purchases of canola seeds, canola oil, and fish. The United States accounted for a \$1.5-billion increase in Canada's exports, but decreases in exports were the norm for other destinations, particularly to South Korea (down \$465 million) and Pakistan (down \$351 million). Exports to Iraq recovered somewhat from the \$55-million low in 2011, posting \$304 million in 2012.

Agri-food imports rose at a slightly slower pace of 5.9 percent (up \$2.0 billion) to reach \$35.1 billion last year. Meat imports grew by \$354 million, fruits and nuts imports by \$338 million and imports of beverages and spirits, the top import category, increased by \$283 million. The United States remains Canada's major food supplier, accounting for 59.4 percent of Canada's imports, which expanded \$1.8 billion last year to reach \$20.8 billion. Other notable increases were in imports from India (up \$83 million) and Mexico (up \$55 million) while imports from Brazil declined by \$138 million.

Canada's trade surplus in this category continued to widen, increasing by \$1.3 billion to \$12.2 billion in 2012. Japan and China were the top surplus partners, at \$4.1 billion and \$4.0 billion, respectively; Brazil was the top deficit partner at \$838 million.

### **Metals and Minerals<sup>14</sup>**

As prices for resources and resource-related commodities stagnated or declined in 2012 (with the temporary exception of gold), Canada's exports of metals and minerals declined accordingly. The value of exports in this category decreased 8.6 percent (down \$6.4 billion) to \$68.8 billion last year. After

<sup>13</sup> HS Chapters 1-24.

<sup>14</sup> HS Chapters 25, 26 and 68-83.

doubling exports between 2009 and 2011, the leading commodity subgroup, precious stones and metals, registered a \$3.3-billion decline in exports—over half of the total decline. Most of this decline was due to decreased exports of gold and silver. As prices of diamonds, silver, platinum and scrap trended downwards, gold prices continued to climb—but with the recent trends, further declines in this commodity's value will hit the category's export values in 2013. While the dominant exports of precious metals to the United Kingdom held firm, exports to the United States fell 28.5 percent (down \$2.8 billion). The other items whose exports declined substantially were nickel, down \$1.4 billion, and aluminum, down \$1.3 billion on the year. Each suffered major price declines: over 10 percent for aluminum and over 20 percent for nickel. Exports of articles of iron and steel were up \$0.6 billion, the only major subcategory that increased exports in 2012.

Geographically, exports have declined to most destinations, but the declines were substantial to the United States (down 9.7 percent, or \$3.7 billion), Norway (down 18.4 percent, or \$0.5 billion) and Hong Kong (down 30.6 percent, or \$0.4 billion).

Imports of metals and minerals remained unchanged in 2012 at \$57.2 billion. The \$2.1-billion decline in imports of precious metals and minerals was offset by the increased imports of articles of iron and steel (up \$1.2 billion), miscellaneous articles of base metal (up \$0.3 billion) and articles of stone, plaster and cement (up \$0.2 billion). Exports to the United States and China expanded (up \$0.3 billion and

\$0.4 billion, respectively), but those increases were offset by declines in imports from Peru, the United Kingdom, Germany and Chile.

Although declines occurred in 2012, two countries still supply close to half of Canada's \$9.8-billion gold imports: Peru (\$2.8 billion, down 12.5 percent) and Argentina (\$1.7 billion, down 7.5 percent). The United States became the third-largest supplier of gold to Canada last year, with shipments of \$732 million.

Canada's trade balance in metals and minerals shrank considerably last year. A decrease of \$6.5 billion brought the surplus down from \$18.1 billion in 2011 to \$11.6 billion in 2012.

### **Chemicals, Plastics and Rubber<sup>16</sup>**

Canada's exports of chemicals, plastics and rubber declined 4.6 percent, or \$2.2 billion, to \$44.7 billion in 2012. The decline was broad-based as all of the top five products lost export value. Exports of the following fell: plastics, the top subcategory, declined just 0.7 percent to \$12.1 billion; fertilizers (largely potash) fell 7.7 percent to \$7.4 billion; pharmaceutical products fell 7.4 percent to \$5.1 billion; inorganic chemicals (primarily uranium) fell 16.8 percent to \$4.8 billion; and organic chemicals fell 11.1 percent to \$4.6 billion. Exports of rubber grew 5.5 percent to \$4.2 billion, and exports of miscellaneous chemicals grew 9.2 percent to \$2.5 billion, but these results only offset a small part of the decline.

The United States accounted for 76.6 percent of the exports and for most of the decline, down \$1.7 billion in exports, mainly in organic

<sup>15</sup> HS Chapter 71.

<sup>16</sup> HS Chapters 28-40.

and inorganic chemicals and pharmaceutical products. Declines also occurred in exports to China (down 13.5 percent, or \$0.2 billion) and the United Kingdom (down 7.5 percent, or \$0.1 billion). No significant export increases took place in 2012.

Imports of chemicals, plastics and rubber grew 2.9 percent, or \$1.7 billion, to reach \$60.5 billion in 2012. Almost 60 percent came from the United States, which accounted for the biggest import increase of \$1.1 billion. Imports from Switzerland grew 21.7 percent (up \$0.4 billion), and imports from China, Germany and the United Kingdom also registered increases. Imports from Ireland stabilized at \$0.8 billion, while imports from France fell 12.7 percent to \$1.4 billion.

The increases in imports were led by plastics and miscellaneous chemical products, which grew by \$0.7 billion and \$0.6 billion, respectively. Imports of rubber grew \$0.3 billion, while imports of inorganic chemicals declined by \$0.3 billion.

Falling exports and rising imports reversed the process of deficit reduction in this area and propelled Canada's trade deficit in chemicals, plastics and rubber products to \$15.8 billion in 2012, up \$3.9 billion from \$11.9 billion in 2011.

### **Wood, Pulp and Paper<sup>17</sup>**

The export gains of 2010–2011 in this important cluster of Canadian industries were reversed in 2012. A 4.3-percent decline in value drove the exports down \$1.2 billion to reach \$26.2 billion overall. Losses were driven by the \$1.3-billion drop in paper and paperboard exports and by

the \$0.8-billion drop in exports of wood pulp. These losses were mitigated somewhat by a \$0.9-billion increase in exports of wood and articles of wood.

By destination, nearly two thirds of these exports were bound for the United States. While most of the reductions occurred to that destination, they were proportionately smaller than its share. Exports to the U.S. market were down only 1.9 percent, or \$320 million. However, declines across the board to many other destinations, primarily Indonesia (down \$101 million), Italy (down \$86 million), Japan (down \$70 million), the United Kingdom (down \$66 million), the Netherlands (down \$66 million) and India (down \$65 million) caused the bulk of the fall in exports. Exports to China held steady at \$4.1 billion.

Imports of wood, pulp and paper fell 3.1 percent last year, or \$383 million, to \$12.0 billion. The United States accounted for the whole decline, with a drop of \$437 million (down 4.6 percent)—primarily in paper and paperboard. Imports from China increased (up 5.4 percent, or \$63 million) as did imports from Mexico (up 26.7 percent, or \$28 million). By subcategory, imports of wood and wood articles grew 5.2 percent while imports of paper and paperboard, printed matter, and especially wood pulp, declined.

The overall decline was much greater for exports than for imports, leading to a \$0.8-billion reduction in Canada's trade surplus in wood, pulp and paper products (down 5.3 percent) to reach \$14.2 billion in 2012.

<sup>17</sup> HS Chapters 44–49.



### Textiles, Clothing and Leather<sup>18</sup>

Canada's exports of textiles, clothing and leather, the smallest export category, expanded again in 2012, gaining 3.8 percent, or \$178 million, to reach \$4.8 billion. Increased exports to the United States (up \$79 million), to Hong Kong (up \$72 million) and to China (up \$67 million) accounted for the overall gains, despite exports to South Korea falling by 55.8 percent (down \$55 million). Among the major subcategories, furskins and artificial fur registered a large export increase (up 33.9 percent, or \$179 million), with Hong Kong, China and the United States accounting for most of that increase. Exports were stable in most of the other major subcategories.

Canada's imports of textiles, clothing and leather rose 1.8 percent in 2012, up \$305 million, to reach \$17.6 billion. China, the top supplier, reduced its shipments by 2.7 percent (down \$209 million). Import flows from most of Canada's other suppliers increased: the United States (up \$158 million); Vietnam (up \$90 million); Bangladesh (up \$66 million); and Cambodia (up \$65 million). Imports of knitted and crocheted apparel and accessories, the top category, declined by \$90 million, counteracted by increases in imports of various textile articles (up \$114 million); articles of leather (up \$101 million); and footwear (up \$81 million).

Exports grew faster than imports, but since import gains were much larger and import expansion was greater in absolute terms, Canada's trade deficit in textiles, clothing and leather increased by \$0.1 billion (up 1.0 percent) to reach \$12.8 billion in 2012.

### Consumer Goods and Miscellaneous Manufactured Products<sup>19</sup>

Exports of consumer goods and miscellaneous manufactured products expanded by 5.7 percent in 2012, gaining \$1.1 billion to reach the \$20.7-billion mark. The increase was due to greater exports to the United States (up \$1.3 billion). Exports declined to Germany (down \$135 million) and Switzerland (down \$97 million). By subcategory, the biggest increases in exports occurred for miscellaneous manufactured articles (up 443.8 percent, or \$591 million, mainly towels, tampons and diapers to the United States) and furniture (up 4.0 percent, or \$179 million). Exports of toys, games and sporting equipment declined by \$187 million, and exports of works of art declined by \$133 million.

Imports of consumer goods and miscellaneous manufactured products grew 8.4 percent in 2012 (up \$1.8 billion), reaching a record-high \$23.4 billion. Imports were up from the United States by \$1.4 billion; from Mexico by \$291 million; and from China by \$168 million. Imports from Cuba decreased by \$163 million. Furniture remained the main import article in this category, gaining \$0.9 billion in a broad-based increase from several top suppliers: the United States, China, Mexico and Vietnam.

The trade balance in consumer goods and miscellaneous manufactured products deteriorated by \$0.7 billion in 2012, with Canada's trade deficit in this category reaching \$2.7 billion.

<sup>18</sup> HS Chapters 41-43, 50-65.

<sup>19</sup> HS Chapters 66, 67 and 91-99.



### Other Transportation Equipment<sup>20</sup>

Non-motor vehicle transportation equipment, which includes aircraft, railway stock, ships and boats, is an important export category for Canada. In 2012, exports of other transportation equipment picked up from the six-year low in 2011, gaining \$701 million (up 6.7 percent). Exports to the United States increased by \$839 million and exports to the United Arab Emirates grew by \$278 million, both on the strength of higher aircraft exports. Exports to Poland, the United Kingdom and Indonesia also experienced sizeable growth for the same reason. By contrast, decreased aircraft exports caused exports to Germany to decline by \$212 million and pushed exports to France down by \$161 million. Overall, aircraft exports increased by \$567 million and railway rolling stock exports increased by \$95 million.

Imports of other transportation equipment declined by 5.2 percent (down \$422 million) in 2012 to \$7.7 billion. The bulk of the decrease was caused by lesser imports from France (down \$205 million, or about 30 percent) and the United States (down \$95 million). Fewer aircraft imports accounted for the decline in imports from France, while fewer imports of rolling stock were responsible for the decline in imports from the United States. Imports of aircraft parts from Japan picked up by \$113 million. Overall, imports of aircraft and parts declined by 1.1 percent, and imports of ships and boats fell by 34.5 percent (down \$408 million, mostly due to the decline in imports of ships from Norway and China).

With growing exports and falling imports, Canada's trade surplus in other transportation equipment expanded by \$1.1 billion to \$3.4 billion in 2012.

### Trade by Provinces and Territories

In 2012, international trade developments affected Canadian provinces and territories in different—and frequently opposite—ways. Half of Canada's provinces and territories experienced increases in trade, while the other half underwent declines, on both the export and the import sides. Ontario captured most of the export gains, as the province is very involved in the increased trade in the recovering automotive sector. Exports expanded by \$5.8 billion (up 3.2 percent) to reach \$187.2 billion. This accounted for 84.1 percent of Canada's export growth. Ontario's exports of automotive products increased by more than that amount, growing \$8.6 billion (up 17.6 percent). The other big increases occurred in exports of mechanical machinery, which grew \$0.8 billion (up 4.5 percent) and aircraft, which expanded \$0.6 billion (up 21.8 percent). These gains were partly offset by declining exports of precious metals and stones, which fell by \$2.7 billion (down 12.0 percent)—primarily gold, silver and coin. The other three significant commodities with reduced exports were nickel and nickel articles (down \$1.2 billion, or 24.2 percent); inorganic chemicals (mainly uranium, down \$0.9 billion, or 30.7 percent); and electrical machinery (down \$0.5 billion, or 5.2 percent).

Imports expanded by \$6.8 billion (up 2.7 percent) in 2012, reaching \$261.8 billion, which was 56.7 percent of Canada's total imports. This occurred in spite of a significant cutback in imports of mineral fuels and oil, down 42.3 percent, or \$4.2 billion, in a broad-based decline. This decline was offset by increased imports in the automotive sector (up \$5.7 billion, or 11.4 percent); the mechanical machinery sector (up

<sup>20</sup> HS Chapters 86, 88 and 89.

\$1.7 billion, or 4.7 percent); and several others, including precision instruments, plastics and furniture. Declines also took place in the imports of precious metals and stones (down \$619 million); paper and paperboard (down \$315 million); and electrical machinery (down \$206 million).

**Alberta** was the second-largest exporting province, with exports equivalent to about half of Ontario's exports and 21.0 percent of Canada's exports. Export growth was slow at 1.8 percent in 2012, producing a \$1.7-billion gain to reach \$95.4 billion in exports. The bulk of the growth occurred in mineral fuels and oil, whose exports gained \$1.4 billion, mainly due to increases in crude oil exports, as exports of petroleum gases declined. Gains also took place in exports of cereals, up \$497 million, and canola seeds, up \$306 million. Exports declined

in plastics (down \$420 million); sulfur (down \$361 million); and organic chemicals (down \$291 million). Imports into Alberta continued to grow more rapidly than exports, up 9.6 percent, or \$2.4 billion, to \$27.3 billion. Rising imports of refined oil accounted for about two thirds of the increase; imports of mechanical machinery, articles of iron and steel and precision instruments also increased, while imports of electrical machinery declined. Overall, Alberta posted a \$68.2-billion trade surplus in 2012, and its sum with Ontario's \$74.8-billion deficit roughly added up to Canada's total trade deficit.

**Saskatchewan** ranked second as a driver of export growth last year, posting a \$3.0-billion increase (up 10.1 percent), and the fourth-largest exporter in Canada with exports totalling \$32.6 billion. Exports grew for mineral fuels

**TABLE 5.2**  
Merchandise Trade by Province and Territory, 2012  
(\$ millions and %)

	2012 Exports \$	Export Growth %	Export Share %	2012 Imports \$	Import Growth %	Import Share %
Ontario	186,984	3.2	41.2	261,824	2.7	56.7
Alberta	95,406	1.8	21.0	27,252	9.6	5.9
Quebec	63,570	-0.1	14.0	74,796	0.3	16.2
Saskatchewan	32,570	10.1	7.2	11,068	17.7	2.4
British Columbia	31,745	-4.3	7.0	42,737	5.8	9.2
New Brunswick	14,774	-0.3	3.3	13,135	-3.8	2.8
Newfoundland	11,309	-6.8	2.5	5,333	46.2	1.2
Manitoba	11,266	-4.5	2.5	19,129	18.1	4.1
Nova Scotia	3,822	-14.3	0.8	6,629	-20.6	1.4
Northwest Territories	1,832	-12.1	0.4	0	-57.9	0.0
PEI	871	15.4	0.2	38	-38.3	0.0
Yukon Territory	216	42.7	0.0	86	-18.1	0.0
Nunavut	15	82.8	0.0	31	-81.4	0.0
<b>TOTAL</b>	<b>454,377</b>	<b>1.5</b>	<b>100.0</b>	<b>462,059</b>	<b>3.5</b>	<b>100.0</b>

Source: Office of the Chief Economist, DFATD; with data from Statistics Canada.

and oil (up \$2.4 billion due to crude oil); canola seeds (up \$0.6 billion); and wheat (up \$0.5 billion). On the other hand, exports of fertilizers (potash) lost \$0.6 billion and exports of vegetables went down \$0.5 billion. Imports grew 17.7 percent, or \$1.7 billion, to reach \$11.1 billion, driven by mechanical machinery and automotive products.

**Quebec's** exports remained stable at \$63.6 billion. Declines in exports of top commodities—aluminum (down \$1.2 billion); paper and paperboard (down \$0.6 billion); aircraft (down \$0.3 billion); and copper (down \$0.3 billion)—counteracted growth in exports of ores and ash (up \$0.4 billion); mineral fuels and oils (up \$0.4 billion, refined oil); and mechanical machinery (up \$0.4 billion, aircraft engines). Imports registered a small 0.3-percent increase (\$0.2 billion) to reach \$74.8 billion. Imports of mineral fuels and oil increased (up \$1.5 billion, crude oil); mechanical and electrical machinery imports increased by \$0.2 billion each; imports of precious metals and stones dropped by almost half (down \$1.4 billion); and imports of inorganic chemicals also declined (down \$0.2 billion).

**British Columbia** experienced a 4.3-percent export contraction (down \$1.4 billion) as the province's exports of coal and petroleum gases fell. Exports of pulp and paper, as well as precious stones and metals, also declined, while growth was observed in wood and articles of wood, machinery, and sulfur exports. Imports showed healthy 5.8-percent growth (up \$2.3 billion), driven by a \$1.0-billion increase in mechanical machinery imports. Imports of electrical machinery and automotive products also grew, while imports of mineral fuels and oil declined considerably, mostly in non-crude oil.

**Newfoundland and Labrador's** exports also declined in 2012, by 6.8 percent, losing \$0.8 billion to reach \$11.3 billion. A decline in crude oil exports was partly offset by an increase in exports of refined oil. Exports of iron ores also declined, and exports of nickel were not reported; fish and seafood exports contracted as well. The only significant increase was in aircraft exports, up \$250 million. Meanwhile, imports into the province were booming, up 46.2 percent, the fastest rate in the country. This was due to imports of mineral fuels and oil (mostly crude oil) increasing in excess of 50 percent (up \$1.7 billion).

**New Brunswick's** exports of mineral fuels and oil held steady, and overall exports followed suit, staying at \$14.8 billion. Fish and seafood exports grew 18.9 percent (up \$122 million). Imports declined \$0.5 billion, mainly due to crude oil and petroleum gases. **Manitoba** underwent a 4.5-percent decrease in exports (down \$531 million), as exports of wheat and canola seeds declined. Imports grew robustly at 18.1 percent, up \$2.9 billion, due to increased shipments of various mechanical machinery and automotive products. Exports of tires held steady as **Nova Scotia's** main export, but the province's exports declined overall by 14.3 percent, or \$639 million, due in equal parts to the drop in exports of paper and paperboard and exports of mineral fuels and oil (mostly petroleum gases). Imports also declined sharply, down 20.6 percent, or \$1.7 billion, as crude oil and mechanical machinery imports were cut nearly in half. In **Prince Edward Island**, exports grew \$116 million, about half of the growth due to the doubling in exports of aircraft engines. Exports of potatoes and fish also expanded. On the other hand, imports declined by 38.3 percent. In the **Northwest Territories**,

diamond exports declined somewhat, reducing total exports by 12.2 percent, while **Nunavut** started exporting diamonds—new shipments worth \$4 million contributed to the \$7-million

overall export growth. Growth in shipments of copper, zinc and lead ores led the **Yukon Territory** to a \$65-million gain in exports last year (up 42.7 percent). ■

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<sup>i</sup> Data collected and presented on the Customs basis measures the change in the stock of material resources of the country resulting from the physical movement of merchandise, in this case, into or out of Canada. When goods are imported into or exported from Canada, declarations must be filed with the Canadian Border Services Agency (CBSA) detailing such information as description and value of goods, origin and port of clearance of commodities and mode of transport.

To obtain data on the Balance of Payments (BOP) basis, Customs basis information is adjusted to conform to the Canadian System of National Accounts concepts and definitions, so as to cover all economic transactions between residents and non-residents that involve merchandise trade.

The main differences between the two modes of data presentation are as follows: on a BOP basis, transactions are defined in terms of ownership change (i.e. BOP trade can sometimes occur completely within or completely outside of Canada). On a Customs basis, a transaction occurs when a good crosses the border. Other major differences involve the country of attribution for imports (for BOP, it is the country of shipment; for Customs, it is the country of origin) and valuation (most notably, freight for BOP purposes is moved out of merchandise trade and into transportation services). BOP adjustments to Customs data are frequently carried out at aggregate levels (both for commodity and country groupings), making it difficult, or sometimes impossible, to determine the direct relationship between detailed Customs data and the BOP data.

# Overview of Canada's and Global Investment Performance

After a spell of increased activity in foreign direct investment (FDI) in 2011, global investment retreated again in 2012. In 2011, FDI was largely fuelled by corporate restructuring, investors' heightened interest in gaining access to resources around the world, and growth in greenfield investment, whereas in 2012, all components of FDI declined, with greenfield investment particularly hard hit. Policy uncertainty and global macroeconomic fragility restrained investor confidence and limited investment opportunities.

For the first time, developing countries attracted more investment interest than developed countries—although only a fraction of those inflows was invested in new projects. The global trends were mostly explained by a sharp reduction in investment in the European Union and United States, both as donors and as recipients of investment flows, although activity went down across the world.

Canada was one of the few countries that did not follow the global pattern, as both inflows and outflows of FDI grew robustly during 2012, in stocks and in flows.<sup>1</sup> Inward flows posted stronger growth once again, with the EU the leading source of the increase. The

investment boom in Ontario green energy projects that propelled the province into the top three regions in North America for greenfield investment in 2011 continued in 2012.

Canadian direct investment abroad (CDIA) also grew strongly, with the focus on Canada's traditional investment areas in foreign countries: the finance and insurance sector; the mining and oil and gas extraction sector; and the management of companies and enterprises sector. In addition to the strong growth to Canada's most popular investment destinations (i.e., the United States and the EU), CDIA also increased considerably in Norway, Chile and Australia. Overall, Canada's net direct investment asset position improved marginally in 2012.

## Global Foreign Direct Investment Flows

Global inflows of FDI declined by 18 percent in 2012, driven by policy uncertainty and macroeconomic fragility across the world economy. Total FDI inflows declined from \$1,604 billion<sup>2</sup> in 2011 to \$1,311 billion in 2012—the lowest annual level since the economic crisis, and barely above the 2009 trough of \$1,200

1 Foreign direct investment (FDI) flows represent yearly movements of capital across national borders that are invested into domestic structures, equipment and organizations, or in equity if the result is a resident entity in one country obtaining a lasting interest in an enterprise resident in another country. In practice, direct investment is deemed to occur when a company owns at least 10 percent of the voting equity in a foreign enterprise. FDI stock is the total accumulated worth of all such investment held abroad by a country's nationals. Due to constant changes in valuation and different methods of data collection, summing FDI flows does not provide accurate FDI stock information.

2 All data on global FDI flows in this chapter are expressed in US\$; FDI inflows are from the United Nations Conference on Trade and Development (UNCTAD) Global Investment Trends Monitor #11. Data on global FDI outflows were not available from UNCTAD this year; partial data were obtained from the OECD international direct investment database, but these sources are not necessarily fully consistent with each other.

billion. This decline in inflows contrasted with the generally increasing levels of other macro-economic variables, such as employment, GDP and trade. As a whole, FDI inflows into **developing economies** held up well in 2012, retreating just 3.2 percent from \$703 billion in 2011 to \$680 billion in 2012. In fact, FDI inflows into developing economies exceeded FDI inflows into developed economies by \$130 billion—the first time developing economies have ever received more FDI than developed economies (Table 6-1).

**Developing Asia** was the leader in FDI inflows in 2010, but growth slowed down in 2011 and was reversed in 2012, as FDI inflows declined 9.5 percent to \$399 billion. Investment in China slowed 3.5 percent, as rising costs of production and weaker demand for exports took hold; nevertheless, China remained the world's second-largest recipient of FDI. Elsewhere in Asia, more substantial declines took place as the investment boom of 2011 moderated. FDI inflows into Hong Kong, the world's third-largest FDI recipient, declined by almost 25 percent; FDI in India fell 13.6 percent; FDI in Malaysia fell 16.7 percent; and FDI in Singapore declined 15.0 percent. Still, some economies in Southeast Asia, such as the Philippines, Thailand, Cambodia, Myanmar and Vietnam, attracted more investment in 2012 than before. FDI into West Asia continued its four-year decline, and in 2012 Turkey did not buck the downward trend, after undergoing rapid FDI growth in 2011. FDI inflows in Turkey fell 22.0 percent as cross-border merger and acquisition (M&A) activities weakened.

FDI inflows to **Latin America and the Caribbean** again led the increase among the developing economies—rising from \$217.0 billion to \$232.6 billion—although the buoyant

growth of 2011 moderated to 7.2 percent in 2012. The region's strength in natural resources, and its relatively strong economies, continued to encourage investment in extractive industries, which motivated a number of investments in Colombia, Chile and Peru. Chile's growth was particularly robust (over 50 percent), accounting for 2.0 percent of global investment in 2012 (\$26.4 billion). Brazil's inflows slowed marginally after a spectacular 2011 performance, which was partly due to repatriation of capital; FDI flows into Mexico declined again, down 16.3 percent to \$17.4 billion.

FDI inflows to **Africa** increased 5.5 percent in 2012 to \$45.8 billion. Prospects looked better in North Africa where FDI inflows reversed their downward trend; FDI in Egypt rose from negative \$0.5 billion to \$3.5 billion, sourced mainly from European investors. Angola did better than in 2010 and 2011, while investment in South Africa picked up from \$5.8 billion to \$6.4 billion.

FDI inflows to transition economies (**emerging Europe and the CIS**) declined 13.1 percent, from \$93.7 billion in 2011 to \$81.4 billion in 2012. Southeastern Europe, whose primary donors are European, was particularly affected, with a sharp 52-percent drop. Investment in Russia, which accounted for over half of the region's FDI inflows, also decreased in 2012, down 16.6 percent; this was partially offset by increased flows to Kazakhstan and Ukraine.

FDI inflows into **developed** countries as a group underwent a sharp decline, losing almost a third of their value in 2012. Falling from \$807.8 billion to \$548.9 billion, investment dipped below that in the developing countries for the first time—a portentous event. The decline was equally sharp in the EU and the United States, while Japan's aggregate inflows

TABLE 6-1								
Global FDI Flows by Region and Selected Countries (US\$ billions and %)								
	FDI inflows				FDI outflows			
	2011	2012 <sup>i</sup>	Change (%)	Share (%)	2011	2012 <sup>i</sup>	Change (%)	Share (%)
<b>World</b>	<b>1,604.2</b>	<b>1,310.7</b>	<b>-18.3</b>	<b>100.0</b>	<b>1,619.0</b>	<b>1,422.7</b>	<b>-12.1</b>	<b>100.0</b>
<b>Developed economies</b>	<b>807.8</b>	<b>548.9</b>	<b>-32.1</b>	<b>41.9</b>	-	-	-	-
Canada	41.4	47.2	14.0	3.6	49.9	53.9	8.0	3.8
Europe	459.3	293.5	-36.1	22.4	-	-	-	-
European Union	440.0	287.0	-34.8	21.9	558.3	418.0	-25.1	29.4
Austria	14.7	5.0	-66.0	0.4	24.8	16.6	-33.1	1.2
Belgium	103.3	19.3	-81.3	1.5	82.6	85.3	3.3	6.0
France	40.9	58.9	44.0	4.5	90.2	62.2	-31.0	4.4
Germany	40.4	1.3	-96.8	0.1	52.2	66.8	28.0	4.7
Ireland	11.5	39.6	244.3	3.0	-4.3	18.9	..	1.3
Italy	34.3	5.3	-84.5	0.4	47.3	30.6	-35.3	2.2
Luxembourg	14.4	22.6	56.9	1.7	9.0	17.0	88.9	1.2
Netherlands	13.6	-2.1	..	..	40.9	-3.5	..	..
Spain	29.5	17.5	-40.7	1.3	36.6	-4.9	..	..
Sweden	14.7	10.1	-31.3	0.8	28.2	33.5	18.8	2.4
United Kingdom	51.1	62.5	22.3	4.8	106.7	71.8	-32.7	5.0
United States	226.9	146.7	-35.3	11.2	419.3	351.4	-16.2	24.7
Japan	-1.8	-0.4	..	..	114.3	122.5	7.2	8.6
<b>Developing economies</b>	<b>702.7</b>	<b>680.4</b>	<b>-3.2</b>	<b>51.9</b>	-	-	-	-
Africa	43.4	45.8	5.5	3.5	-	-	-	-
Egypt	-0.5	3.5	..	0.3	-	-	-	-
South Africa	5.8	6.4	10.3	0.5	2.8	4.4	57.1	0.3
Latin America and the Caribbean	217.0	232.6	7.2	17.7	-	-	-	-
Brazil	66.7	65.3	-2.1	5.0	-1.0	-2.8	..	..
Colombia	13.6	15.8	16.2	1.2	-	-	-	-
Chile	17.3	26.4	52.6	2.0	19.5	20.1	3.1	1.4
Mexico	20.8	17.4	-16.3	1.3	12.1	25.6	111.6	1.8
Asia and Oceania	440.7	399.0	-9.5	30.4	-	-	-	-
China	124.0	119.7	-3.5	9.1	43.0	62.4	45.1	4.4
Hong Kong	96.1	72.5	-24.6	5.5	-	-	-	-
India	31.6	27.3	-13.6	2.1	12.6	8.6	-31.7	0.6
Indonesia	19.2	19.2	0.0	1.5	7.7	5.4	-29.9	0.4
Malaysia	12.0	10.0	-16.7	0.8	-	-	-	-
Singapore	64.0	54.4	-15.0	4.2	-	-	-	-
Thailand	7.8	8.1	3.8	0.6	-	-	-	-
Turkey	15.9	12.4	-22.0	0.9	2.5	4.1	64.0	0.3
<b>Emerging Europe and the CIS</b>	<b>93.7</b>	<b>81.4</b>	<b>-13.1</b>	<b>6.2</b>	-	-	-	-
Russia	52.9	44.1	-16.6	3.4	48.6	31.0	-36.2	2.2

Source: UNCTAD, OECD International Direct Investment Database, IMF, Statistics Canada. Data excludes Special Purpose Entities (SPEs)

<sup>i</sup> Preliminary estimates

- : Data not available



continued to hover around zero, although on the negative side for the third successive year. In Europe, Belgium led the fall with an \$84-billion decline in FDI inflows, while Germany's divestments brought its inflows down from over \$40 billion to nearly zero. Inflows into the United States fell \$80.2 billion, the decline largely driven by the fall in cross-border M&A transactions. Southern Europe fared badly as well—combined FDI inflows into Greece, Italy, Portugal and Spain were less than half what they were in 2011.

FDI inflows increased into Canada and a few other countries—the United Kingdom, France and Ireland—with the latter, in particular, showing a revival of activities by transnational corporations after the collapse of its financial sector in 2008: FDI inflows grew from \$11.5 billion in 2011 to \$39.6 billion in 2012.

The value of cross-border M&As decreased significantly in 2012, particularly in Europe, as global macroeconomic uncertainty led to low corporate confidence. The transnational corporations (TNCs) of several developed countries divested heavily from their foreign assets: for example, the \$12-billion divestments of ING Group in the United States and Canada, and British Petroleum's sale of its stake in a group of oil fields in the Gulf of Mexico for \$5.6 billion. On the other hand, TNCs purchases from developing economies reached \$115 billion—a record-high 37 percent of the world's total purchases.<sup>3</sup> M&A purchases by TNCs from Latin America saw the most rapid increase (to \$28

billion), but Asian investors continue to account for the lion's share (75 percent) of acquisitions from developing countries.

Global greenfield investment declined 34 percent, falling to a record low. The number of FDI projects declined 16.4 percent to 11,789, and the estimated job creation from greenfield FDI declined by 28.8 percent. All regions of the world experienced a decline in greenfield FDI, but the decline in Africa was less than the world's average. The Asia-Pacific region remained the leading destination region for greenfield FDI, while the United States was the leading single destination country. Business and financial services was the top sector for greenfield FDI in 2012.

Data on FDI donors, based on preliminary OECD estimates, do not compare directly with the data on FDI recipients from UNCTAD; nevertheless, both sources show a clear picture of decline in global FDI outflows. According to the OECD, global FDI outflows fell by 12.1 percent in 2012, from \$1,619.0 billion to \$1,422.7 billion. This decrease brought the level of FDI outflows approximately to its 2010 level. Growth was observed in the first quarter, but FDI outflows shrank in the middle of the year, with some recovery under way in the last quarter of the year.<sup>4</sup> Among OECD members, investments abroad declined by 15 percent to \$1,100 billion in 2012, accounting for 77 percent of global FDI (down from 80 percent in 2011).

3 Large deals include the acquisition of Progress Energy Canada Limited by Petronas (Malaysia) for US\$5.4 billion, the purchase of Petrogal Brasil Ltda. (Brasil) by Sinopec Group (China) for US\$4.8 billion and the purchase of EDP Energias de Portugal SA (Portugal) by China Three Gorges Corp. (China) for US\$3.5 billion.

4 According to UNCTAD, global inflows can differ from outflows for various reasons, including different methods of data collection between host and home countries, different data coverage of FDI flows (i.e., treatment of reinvested earnings), and different times used for recording FDI transactions. In addition, the fact that outflows can exceed inflows suggests that part of the outflows recorded in home countries may not necessarily be recorded as inflows in host countries.

The United States, the single largest investor economy in the world, recorded \$351.4 billion of outward FDI, down 16.2 percent from the 2011 level, representing nearly 25 percent of global outflows. Japan was the second-largest FDI donor in 2012, increasing FDI outflows 7.2 percent to \$122.5 billion. Outflows from the EU dropped by over 25 percent to \$418.0 billion. The largest investors in that region were Belgium with \$85.3 billion; the United Kingdom with \$71.8 billion; Germany with \$66.8 billion; and France with \$62.2 billion.

The surge in China's FDI outflows was the most significant among developing countries; its total outflows increased by \$19.4 billion to reach \$62.4 billion in 2012—half the level of Japan and equal to that of France. Brazil's FDI outflows continued to show small divestment, down \$2.8 billion on the year. Mexico's FDI outflows more than doubled, reaching \$25.6 billion. On the other hand, Russia's FDI outflows declined 36.2 percent, and FDI outflows for Indonesia and India each declined around 30 percent.

UNCTAD forecasts that global FDI will increase modestly to \$1.4 trillion in 2013 and to \$1.6 trillion in 2014. Trade, GDP growth and gross fixed capital formation are projected

to rise gradually, particularly in developing countries, bringing pressure on TNCs to invest their record-high cash holdings in new projects. At the same time, any worsening of the macroeconomic situation and continued policy uncertainty could undermine prospects for a sustained FDI recovery.

## Canadian Direct Investment Performance

### Inward Investment

#### *Inflows*

FDI inflows into Canada contracted sharply during the global financial and economic crisis, and a meaningful recovery only began in 2011, when FDI rebounded by over a third. This was followed by another year of growth for FDI in Canada, which increased \$3.7 billion to \$43.0 billion in 2012 (Table 6-2). Inflows slowed down well into the second quarter of the year, but then bounced back strongly in the third quarter, which accounted for over half of the total investment for the year. Most of the growth in 2012 was attributable to the increased net M&As of Canadian interests, which grew \$5.2 billion; reinvested earnings to Canada-based subsidiaries of foreign firms also increased, gaining \$1.0 billion in value, while other flows declined.

**TABLE 6-2**  
FDI Inflows into Canada by Region  
(\$ millions and %)

Source	2011 (\$)	2012 (\$)	Change (\$)	Growth (%)
World	39,254	42,990	3,736	9.5
U.S.	15,349	16,484	1,135	7.4
EU	13,162	19,045	5,883	44.7
Japan	391	3,792	3,401	869.8
Other OECD	1,723	1,396	-327	-19.0
ROW	8,629	2,273	-6,356	-73.7

Source: Statistics Canada

As in 2011, the EU was the leading source of the increase in FDI inflows into Canada in 2012. Flows from the EU rose \$5.9 billion, from \$13.2 billion to \$19.0 billion. Over two thirds of that increase originated from U.K. investors expanding their investment flows by \$4.1 billion to \$9.9 billion in 2012; this exceeded the inflows from all other EU countries combined. The remaining portion of the increase (\$1.8 billion) came from other EU countries. Unlike in 2011, the EU was the top investor in Canada in 2012 (on the yearly inflow basis).

Investment flows from the United States grew 7.4 percent during the year (up \$1.1 billion), accounting for only 38 percent of the total inflows. M&A activities plummeted, from \$12.1 billion in 2011 to \$3.6 billion; that was offset by an increase in transfers of reinvested earnings and other flows. Investment from Japan increased sharply to \$3.8 billion in 2012 from just \$0.4 billion in 2011. Other OECD countries slowed the pace of their investment into Canada somewhat, decreasing their inflows from \$1.7 billion to \$1.4 billion. Investment from the rest of the world (ROW) declined by almost 75 percent, down \$6.4 billion to \$2.3 billion.

The trade and transportation sector was the leading area of interest for foreign investors, receiving over 30 percent of FDI inflows, followed closely by the manufacturing sector, which received 26.6 percent of FDI inflows. These two sectors were followed by management of companies and enterprises (20.0 percent) and energy and mining (16.0 percent). The finance and insurance sector showed foreign divestment for the second consecutive year (down \$1.5 billion), while the remaining 10.7 percent of FDI inflows went to other industries.

As the location for 7.4 percent of all North American greenfield projects, Ontario remained the third-largest recipient of greenfield FDI in North America for the second consecutive year. British Columbia was among the top three destinations in terms of growth potential for greenfield projects, receiving 26.9 percent more greenfield FDI in 2012.

### *Inward FDI Stock*

Foreign investment stocks in Canada increased 5.8 percent in 2012, reaching \$633.9 billion. This represented an increase of \$34.6 billion over the 2011 level, and was considerably higher than the \$6.9-billion increase that took place in 2011. Almost half of the increase was attributable to greater FDI holdings by European investors, which increased by 8.7 percent (\$17.0 billion) to reach \$212.1 billion. As in 2011, the United States accounted for almost all of the remaining increase, with its FDI stock rising 5.0 percent, or \$15.6 billion, to reach \$326.5 billion; the United States accounted for 51.5 percent of the total FDI stock in Canada.

**North America's** FDI stock in Canada as a whole rose \$15.7 billion, with the United States contributing the dominant proportion. Investment from Barbados doubled to \$0.8 billion, while investment from Bermuda declined 8 percent to \$2.2 billion.

The United Kingdom led the increase in **Europe's** FDI in Canada; the U.K.'s total FDI stock rose 15.5 percent, or \$7.3 billion, to \$54.6 billion. Luxembourg again increased its holdings in Canada significantly (up 11 percent, or \$2.5 billion), propelling its FDI stock to \$24.6 billion. The Netherlands remained Canada's largest European investor, with a total FDI stock of \$61.4 billion, after adding \$1.6 billion

<b>TABLE 6-3</b>				
<b>Stock of Foreign Direct Investment into Canada by Country and Region</b>				
<b>(\$ millions and %)</b>				
	<b>2011</b>	<b>2012</b>	<b>Change</b>	<b>Growth</b>
	<b>(\$)</b>	<b>(\$)</b>	<b>(\$)</b>	<b>(%)</b>
<b>All countries</b>	<b>599,326</b>	<b>633,915</b>	<b>34,589</b>	<b>5.8</b>
<b>North America</b>	<b>315,841</b>	<b>331,575</b>	<b>15,734</b>	<b>5.0</b>
Bahamas	76	76	0	0.0
Barbados	454	842	388	85.5
Bermuda	2,353	2,157	-196	-8.3
Mexico	121	x	..	..
United States	310,883	326,527	15,644	5.0
<b>South and Central America</b>	<b>14,603</b>	<b>15,707</b>	<b>1,104</b>	<b>7.6</b>
Brazil	14,527	15,810	1,283	8.8
<b>Europe</b>	<b>195,094</b>	<b>212,101</b>	<b>17,007</b>	<b>8.7</b>
Belgium	4,605	4,683	78	1.7
Finland	1,756	1,753	-3	-0.2
France	13,221	14,843	1,622	12.3
Germany	11,014	11,735	721	6.5
Ireland	2,615	2,508	-107	-4.1
Italy	1,134	1,213	79	7.0
Luxembourg	22,192	24,642	2,450	11.0
Netherlands	59,882	61,448	1,566	2.6
Sweden	1,925	1,938	13	0.7
Switzerland	20,288	21,398	1,110	5.5
United Kingdom	47,253	54,558	7,305	15.5
<b>Africa</b>	<b>2,941</b>	<b>3,666</b>	<b>725</b>	<b>24.7</b>
South Africa	x	x	..	..
<b>Asia/Oceania</b>	<b>70,847</b>	<b>70,865</b>	<b>18</b>	<b>0.0</b>
Australia	5,528	5,634	106	1.9
India	3,730	3,728	-2	-0.1
Japan	15,424	17,486	2,062	13.4
China	11,511	12,037	526	4.6
South Korea	5,633	5,826	193	3.4

Data: Statistics Canada

in assets in 2012. France increased its FDI stock 12.3 percent, or \$1.6 billion, propelling the total to \$14.8 billion. Switzerland, Canada's fourth-largest European investor, added \$1.1

billion to its holdings for the total of \$21.4 billion worth of FDI stock. European countries did not engage in significant divestment of their Canadian FDI stock.

**TABLE 6-4**  
Stock of Foreign Direct Investment into Canada by Major Sector  
(\$ millions and %)

	2011	2012	Change	Growth
	(\$)	(\$)	(\$)	(%)
<b>Total, all industries</b>	<b>599,326</b>	<b>633,915</b>	<b>34,589</b>	<b>5.8</b>
Agriculture, forestry, fishing and hunting	1,570	1,540	-30	-1.9
Mining and oil and gas extraction	113,267	120,248	6,981	6.2
Utilities	3,621	3,675	54	1.5
Construction	2,300	3,383	1,083	47.1
Manufacturing	171,166	181,643	10,477	6.1
Wholesale trade	43,897	48,060	4,163	9.5
Retail trade	27,940	30,048	2,108	7.5
Transportation and warehousing	4,696	8,829	4,133	88.0
Information and cultural industries	1,351	2,322	971	71.9
Finance and insurance	86,900	85,096	-1,804	-2.1
Real estate and rental and leasing	5,691	6,917	1,226	21.5
Professional, scientific and technical services	9,037	10,407	1,370	15.2
Management of companies and enterprises	117,624	121,556	3,932	3.3
Accommodation and food services	3,567	3,630	63	1.8
All other industries	6,701	6,560	-141	-2.1
Information and communication technologies	14,857	13,826	-1,031	-6.9

Data: Statistics Canada

In **South and Central America**, Brazil held over 100 percent of the region's total FDI stock in Canada in 2012. Brazil's total investment increased 8.8 percent (up \$1.3 billion) to reach \$15.8 billion. The rest of the region cumulatively held a negative position in FDI stock in Canada.

Investment stock in Canada from **Asia and Oceania** increased marginally, from \$70.8 billion in 2011 to \$70.9 billion in 2012. The fact that it did not decline was predominantly due to the increase in Japan's FDI stock in Canada, which grew \$2.1 billion (up 13.4 percent) to reach \$17.5 billion—confirming that Japan was Canada's biggest investor in the region. China placed a distant second in 2012, raising its FDI stock 4.6 percent, or \$0.5 billion, to \$12.0

billion. Small increases took place in Australia's and South Korea's holdings, while India's FDI stock in Canada declined marginally. Finally, investment from **Africa** grew 24.7 percent (up \$0.7 billion) to reach \$3.7 billion in 2012.

Just under one third (\$10.5 billion) of the \$34.6-billion increase in FDI stock in Canada in 2012 went into the manufacturing sector—an increase of 6.1 percent. FDI stock in manufacturing reached \$181.6 billion in 2012, accounting for 28.7 percent of all FDI stock in Canada. The other sector where foreign interest increased substantially was mining and oil and gas extraction, where FDI stock rose \$7.0 billion (up 6.2 percent) to reach \$120.2 billion. Investment positions in most other goods sectors remained stable in 2012. A 47-percent

**TABLE 6-5**  
 FDI Outflows from Canada by Region  
 (\$ millions and %)

	2011	2012	Change	Growth
Destination	(\$)	(\$)	(\$)	(%)
World	51,602	55,401	3,799	7.4
U.S.	28,759	29,785	1,026	3.6
EU	8,597	5,594	-3,003	-34.9
Japan	-892	140	1,032	-115.7
Other OECD	1,937	3,614	1,677	86.6
ROW	13,201	16,268	3,067	23.2

Source: Statistics Canada

increase in holdings brought foreign FDI in the construction sector to \$3.4 billion; foreign interests doubled in transportation and warehousing to \$8.8 billion. Significant increases also took place in sectors such as management of companies and enterprises (up \$3.9 billion to \$121.6 billion); wholesale trade (up \$4.2 billion to \$48.1 billion); and retail trade (up \$2.1 billion to \$30.0 billion). Some FDI stock divestment occurred in finance and insurance (down \$1.8 billion to \$85.1 billion) and information and communication technologies (down \$1.0 billion to \$13.8 billion).

## Outward Investment

### Outflows

Canadian direct investment abroad (CDIA) increased \$3.8 billion in 2012 (up 7.4 percent), continuing the process of recovery started in 2011 following the crisis-induced decline. Investment flows increased to all destinations except the EU, where CDIA fell \$3.0 billion, an amount equivalent to more than a third of its 2011 value. CDIA to the United States was up 3.6 percent, or \$1.0 billion, to \$29.8 billion.

CDIA to the other OECD economies almost doubled in 2012, rising \$1.7 billion to \$3.6

billion. CDIA to Japan gained \$1.0 billion, going from a negative position to \$0.1 billion in 2012. Canada's investment flows to the ROW countries grew the most (up 23.2 percent), reversing their decline in 2011 and gaining \$3.1 billion to reach \$16.3 billion.

A more detailed view of Canada's investment outflows shows that M&As of direct investment interests abroad increased by \$6.9 billion; reinvested earnings also grew, gaining \$1.9 billion, while other flows decreased considerably (down \$4.9 billion). By sector, the largest increase in CDIA was directed toward management of companies and enterprises, which gained \$4.2 billion to reach \$13.9 billion (or 25.1 percent of total CDIA for the year). CDIA also increased significantly in the trade and transportation sector, up \$3.6 billion to \$8.7 billion (or 15.7 percent of total CDIA for the year). CDIA into manufacturing declined by over half (\$3.2 billion), accounting for just 4.1 percent of the total. CDIA was down \$0.5 billion in the leading sector, finance and insurance, which accounted for a 33.6-percent share in 2012.

Ontario and Quebec initiated most of Canada's greenfield investment projects abroad. Ontario

initiated 182 FDI projects, the third-highest number of any North American jurisdiction (i.e., among all states and provinces) or 5.8 percent of the total, while Quebec boasted the highest growth in the number of projects initiated (up 24.7 percent to 91).

#### *Outward FDI Stock*

CDIA stock increased 5.5 percent (or \$37.0 billion), from \$674.6 billion in 2011 to \$711.6 billion in 2012, led by the growth in the investment position in the United States. Combined with the change in inward FDI stock, Canada's net direct investment asset position improved slightly to \$77.7 billion in 2012.

While changes in FDI stocks are influenced by net additions and subtractions derived from flows, the change in currency valuation also plays an important—and sometimes decisive—role. CDIA is usually denominated in the currency of the foreign country where the investment is located. This means that when the Canadian dollar is appreciating relative to the local currency, the value of Canadian-held investment abroad in Canadian dollars decreases, and vice versa. By contrast, since foreign direct investment in Canada is directly recorded in Canadian dollars, fluctuations of the Canadian dollar have no impact on the recorded value.

In terms of start-to-end of year valuation, in 2012, the Canadian dollar appreciated by 2.2 percent against the US dollar, by 0.6 percent against the euro, and by 15.1 percent against the Japanese yen, and depreciated by 2.3 percent against the British pound. This created a negative valuation effect for the Canadian dollar in most cases, decreasing the value of most of Canada's foreign investment holdings.

Canadian direct investment stock in **North America** increased by \$18.3 billion, or 4.6 percent, to reach \$417.9 billion in 2012. The United States accounted for most of that increase since flows to that destination increased \$15.3 billion to reach \$289.4 billion. Increases in Canadian direct investment stock elsewhere in the region were less significant: Bermuda (up \$1.0 billion), Cayman Islands (up \$1.0 billion) and Barbados (up \$0.6 billion). These three destinations combined held a total of \$101.2 billion worth of Canadian investment in 2012. Total Canadian direct investment in Mexico increased by \$0.6 billion to \$5.6 billion.

Canadian direct investment in **Asia and Oceania** increased 9.7 percent in 2012 (up \$5.6 billion) to reach \$63.6 billion. The largest increase took place in Australia, where Canada's position improved by \$2.1 billion (up 8.5 percent) to reach \$26.9 billion. Other notable increases in Canadian investment in Asia took place in China (up \$1.1 billion, or 35.2 percent) and Singapore (up \$0.9 billion, or 67.8 percent). Canada's investment stock in Japan declined by \$0.8 billion (down 11.3 percent) despite positive FDI outflows to Japan, which may have been a valuation effect.

**Europe** remained an important destination for Canada's investors, accounting for 26.2 percent of all CDIA stock. CDIA stocks in Europe increased 3.7 percent (up \$6.7 billion) to end up at \$186.1 billion for the year. The United Kingdom was the leading destination for that increase, with CDIA stock there growing by \$6.7 billion (up 8.4 percent) to \$86.8 billion, and accounted for nearly half of all CDIA stock in Europe. Canada made a large investment in Norway and also increased its investments in Luxembourg and Hungary (up \$1.9 billion and \$1.8 billion, respectively). However, decreases



<b>TABLE 6-6</b>				
Stock of Canadian Direct Investment Abroad by Country and Region				
(\$ millions and %)				
	2011	2012	Change	Growth
	(\$)	(\$)	(\$)	(%)
<b>All countries</b>	<b>674,622</b>	<b>711,621</b>	<b>36,999</b>	<b>5.5</b>
<b>North America</b>	<b>399,624</b>	<b>417,947</b>	<b>18,323</b>	<b>4.6</b>
Barbados	58,729	59,305	576	1.0
Bermuda	10,784	11,774	990	9.2
British Virgin Islands	2,225	2,059	-166	-7.5
Cayman Islands	29,218	30,170	952	3.3
Mexico	5,015	5,569	554	11.0
United States	274,128	289,426	15,298	5.6
<b>South and Central America</b>	<b>34,517</b>	<b>40,381</b>	<b>5,864</b>	<b>17.0</b>
Argentina	2,676	4,553	1,877	70.1
Brazil	9,923	9,844	-79	-0.8
Chile	11,361	13,726	2,365	20.8
Colombia	1,196	1,762	566	47.3
Peru	5,909	6,908	999	16.9
Venezuela	912	898	-14	-1.5
<b>Europe</b>	<b>179,425</b>	<b>186,131</b>	<b>6,706</b>	<b>3.7</b>
Belgium	1,450	1,250	-200	-13.8
Cyprus	3,246	3,649	403	12.4
France	5,441	4,684	-757	-13.9
Germany	7,296	7,415	119	1.6
Hungary	11,852	13,692	1,840	15.5
Ireland	18,973	15,832	-3,141	-16.6
Italy	291	292	1	0.3
Luxembourg	17,830	19,733	1,903	10.7
Netherlands	13,485	11,646	-1,839	-13.6
Russian Federation	4,494	4,816	322	7.2
Switzerland	4,755	3,802	-953	-20.0
United Kingdom	80,097	86,813	6,716	8.4
<b>Africa</b>	<b>3,104</b>	<b>3,600</b>	<b>496</b>	<b>16.0</b>
South Africa	3,204	3,042	-162	-5.1
<b>Asia/Oceania</b>	<b>57,952</b>	<b>63,562</b>	<b>5,610</b>	<b>9.7</b>
Australia	24,784	26,895	2,111	8.5
People's Republic of China	3,136	4,239	1,103	35.2
Hong Kong	7,117	7,130	13	0.2
India	655	644	-11	-1.7
Indonesia	3,168	3,218	50	1.6
Japan	7,169	6,362	-807	-11.3
Kazakhstan	2,017	x	..	..
Mongolia	1,586	1,936	350	22.1
Singapore	1,384	2,323	939	67.8
South Korea	491	569	78	15.9

Data: Statistics Canada

**TABLE 6-7**  
Stock of Canadian Direct Investment Abroad by Major Sector  
(\$ millions and %)

	2011	2012	Change	Growth
	(\$)	(\$)	(\$)	(%)
<b>Total, all industries</b>	<b>674,622</b>	<b>711,621</b>	<b>36,999</b>	<b>5.5</b>
Agriculture, forestry, fishing and hunting	#N/A	#N/A	#N/A	#N/A
Mining and oil and gas extraction	126,451	133,724	7,273	5.8
Utilities	14,069	14,418	349	2.5
Construction	536	576	40	7.5
Manufacturing	69,515	69,305	-210	-0.3
Wholesale trade	12,012	13,048	1,036	8.6
Retail trade	6,604	8,201	1,597	24.2
Transportation and warehousing	22,000	24,774	2,774	12.6
Information and cultural industries	28,205	28,715	510	1.8
Finance and insurance	271,153	284,079	12,926	4.8
Real estate and rental and leasing	17,306	18,754	1,448	8.4
Professional, scientific and technical services	7,871	10,523	2,652	33.7
Management of companies and enterprises	85,467	92,126	6,659	7.8
Accommodation and food services	2,834	2,858	24	0.8
All other industries	4,502	4,556	54	1.2

Data: Statistics Canada

occurred in a few European countries: Canada shed \$3.1 billion of FDI stock in Ireland (down 16.6 percent); \$1.8 billion in the Netherlands (down 13.6 percent); and \$1.0 billion in Switzerland (down 20.0 percent).

Canada's investment stock in **South and Central America** experienced the highest yearly growth of all regions in 2012, increasing by 17.0 percent (up \$5.9 billion) to reach \$40.4 billion. Large growth in investments in Chile (up \$2.4 billion, or 20.8 percent) and Argentina (up \$1.9 billion, or 70.1 percent) fuelled this expansion. Growth was also observed in Canada's FDI stock in Peru (up \$1.0 billion, or 16.9 percent) and Colombia (up \$0.6 billion, or 47.3 percent). The stock of Canadian FDI in Brazil and Venezuela remained essentially unchanged.

Canada's investment stock in **Africa** also grew, by a robust 16.0 percent, from \$3.1 billion in 2011 to \$3.6 billion in 2012, reversing the losses of 2011 and gaining \$0.5 billion. Nevertheless, Canada's FDI stock declined to South Africa, the largest investment destination on the continent, from \$3.2 billion to \$3.0 billion (down 5.1 percent).

Investment in goods-producing industries accounted for almost 20 percent of the total increase in FDI stock abroad in 2012, while the increase in the stock of investment in service industries exceeded 80 percent. After growing robustly in 2011, CDIA in the manufacturing sector stalled in 2012; the only sizeable gains occurred in mining and oil and gas extraction—the largest sector for Canadian investment in goods. Investment in this sector

gained \$7.3 billion, or 5.8 percent, to reach \$133.7 billion in total. Service industries gained \$29.7 billion in 2011, with the biggest gain of \$12.9 billion occurring in finance and insurance (up 4.8 percent). Finance and insurance stock held by Canadians in foreign countries reached \$284.1 billion, nearly 40 percent of all CDIA. Major growth also occurred in the management of companies and enterprises sector, which reversed the declines of 2011 to

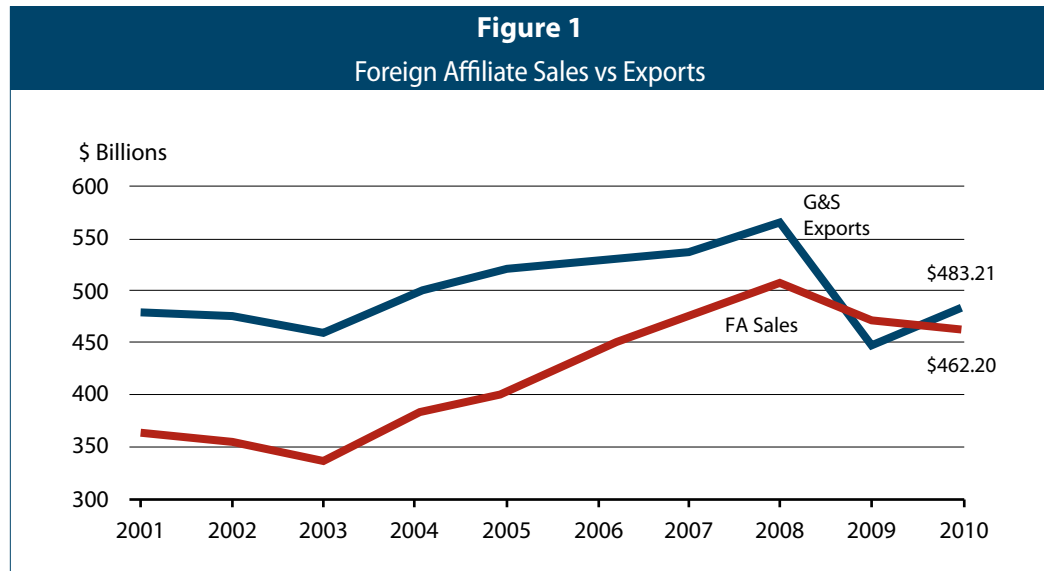
post a \$6.7-billion increase in 2012 (up 7.8 percent). CDIA also expanded in transportation and warehousing (up \$2.8 billion, or 12.6 percent); professional, scientific and technical services (up \$2.7 billion, or 33.7 percent); retail trade (up \$1.6 billion, or 24.2 percent); and real estate and rental and leasing (up \$1.4 billion, or 8.4 percent). CDIA in other service sectors increased by lesser amounts. ■

## Performance of Canadian Foreign Affiliates

Sales by Canadian-owned Foreign Affiliates (FAs)<sup>1</sup> represent another avenue besides exports allowing Canadian goods and services to reach international markets. As such, FAs increase the potential for Canadian businesses to grow. Indeed, FA sales have become increasingly important during the past decade. In 2001, FA sales were equivalent to about 76 percent of Canadian goods and services exports; in 2010, FA sales were equivalent to 96 percent of exports. Since the 2008 crisis however, FA sales have suffered. With the exception of emerging markets<sup>2</sup>, FA sales declined throughout all regions in 2010. As well, FA sales in both goods and services were down, with services sales falling three times as fast as goods. Although FA sales declined in 2010, employment by FAs rose 3.8 percent.

### FA Sales compared to Exports

As Figure 1 shows, in the wake of the 2008 crisis, exports fell more drastically (down 21.4 percent) than FA sales (down 6.8 percent), such that in 2009 FA sales actually exceeded exports by \$27 billion. However, between 2009 and 2010, exports rebounded 8.4 percent whereas FA sales continued to decline (down 2.2 percent). Consequently, FA sales were \$21 billion less than exports in 2010. However, FA sales in the European Union (EU) exceeded Canadian exports to the EU by a factor of 1.4 in 2010 and FA sales in emerging markets exceeded Canadian exports to these regions by a factor of 2.2 during the same year. By



1 Following international statistical practices, only data on majority-owned foreign affiliates are included while depository institutions and foreign branches are excluded. Even if Canadian ownership of an FA is less than 100 percent, the data represent 100 percent of the sales and employment figures.

2 Emerging markets includes all non-OECD countries.

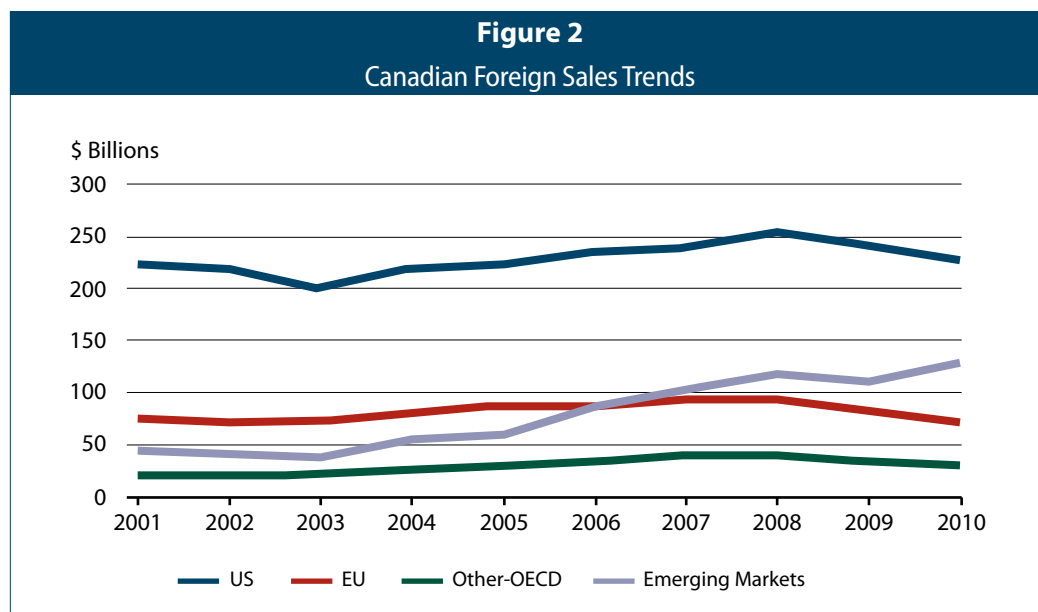
contrast, Canadian exports to the United States and to other OECD<sup>3</sup> countries exceeded FA sales in those regions in 2010.

### FA Sales by Region

In 2010, the only region to post an increase in FA sales was emerging markets, increasing by \$16.5 billion. FA sales in emerging markets out-paced growth in all other regions throughout 2001 to 2010. As a result, emerging markets' share of Canadian FA sales more than doubled during this period, expanding from 12 percent to 28 percent. However, in absolute terms, the United States remained the largest market for Canadian FA sales, as it was for Canadian exports. In other words, although FA sales to the U.S. market decreased by \$11.6 billion in 2010, the U.S. still accounted for almost half (49 percent) of all Canadian FA goods and services sales. FA sales in the EU and in other OECD countries also decreased, by \$11.3 billion and \$4.0 billion, respectively. With the trough of the 2008 recession not far in the past, FA sales in 2010 remained below pre-crisis levels, except in emerging markets where they surpassed 2008 values (Figure 2).

### FA Sales by Sector

Decreases in sales of both goods and services contributed to the total loss of \$10.4 billion in FA sales for 2010. FA services sales fell \$6.6 billion (down 3.9 percent), with widespread losses across most service sectors—with the exception of transportation and warehouse services,



3 Other OECD countries include: Australia, Chile, Iceland, Israel, Japan, Mexico, New Zealand, Norway, South Korea, Switzerland and Turkey.

which increased \$4.3 billion. Meanwhile, FA goods sales, which accounted for 65 percent of total FA sales in 2010, shrank by \$3.9 billion (down 1.3 percent) to \$300 billion. Lower sales in manufacturing, the largest goods sector, led this decline (down \$11.8 billion). A \$7.3-billion growth in the mining, oil and gas extraction sector partially offset these losses.

Throughout the 2001-2010 decade, manufacturing’s share of FA sales decreased from 48 percent to 38 percent, while the share of mining, oil and gas extraction expanded from 11 percent to 23 percent during the same period. In percentage terms, the agriculture, forestry, fishing, and hunting sector (the smallest sector) grew the fastest, increasing sales by 588 percent during this period—the majority of which occurred in 2010 when sales increased from \$3.5 billion to \$6.1 billion. Manufacturing, mining and oil and gas extraction, and finance (non-bank) and insurance, continue to be the three largest sectors for FA sales.

### Employment by Foreign Affiliates

In 2010, Canadian-owned FAs added 41,000 employees to their payrolls. Employment increased in all regions, with the exception of other OECD countries where employment shrank by 4.3 percent (down 3,000 jobs). In emerging markets, growth in FA sales was accompanied by the largest employment increase in 2010: 30,000 more jobs. Employment in FAs located in the U.S. and the EU rose by 6,000 and 8,000, respectively.

Across sectors, for both goods and services, FAs posted increases in employment, with the lion’s share contributed by goods sectors, which added 34,000 jobs in 2010. Despite lower sales in 2010, manufacturing FAs accounted for 41 percent of all FA employment, adding 25,000 more jobs. ■

