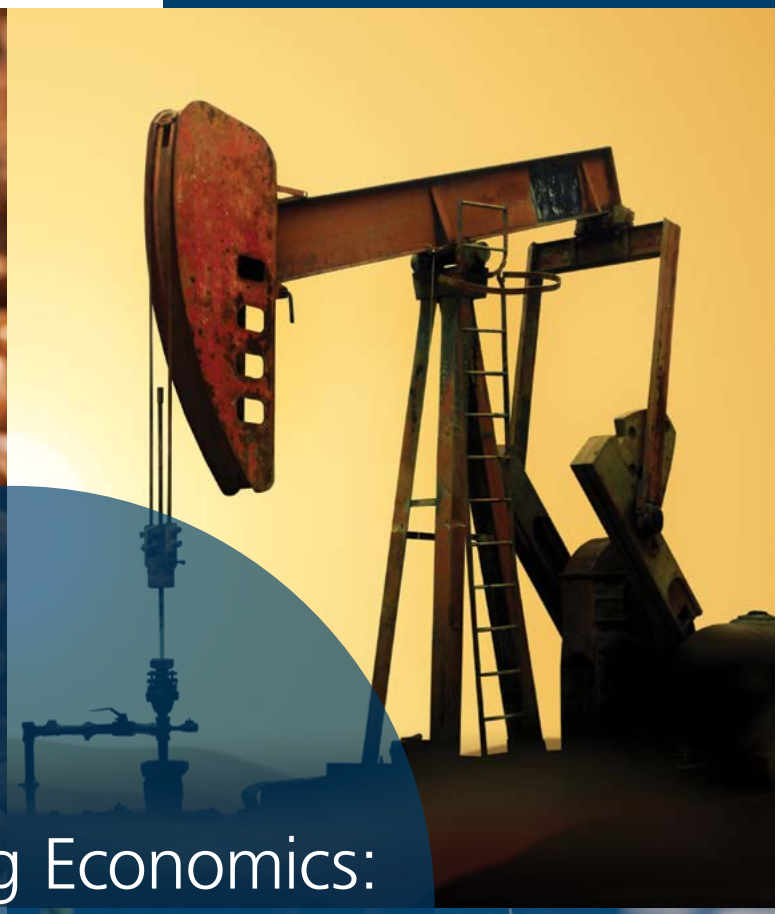

FCC Ag Economics:
A 2015 Look at Global Trade

Farm Credit Canada
Advancing the business of agriculture

Canada

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Introduction

Trade is an integral component of Canada's agriculture and agri-food system, helping to keep the system healthy and vibrant. Canadian trade volumes are significant enough that Canada is among the world's top importers and exporters of agriculture and agri-food products.

Canada's trade flows result from the interaction of many different economic forces, including the value of the Canadian dollar. Conventional wisdom suggests a low Canadian dollar boosts Canadian exports, as our products become relatively cheaper and more competitive in global markets. A lower loonie is seen as an overall positive outcome for Canadian agriculture and agri-food because we export more than we import. 2015 has already witnessed the Canadian dollar reaching lows not seen in a decade, and some projections call for our currency to reach new lows in 2016.

Challenging the wisdom: does a low Canadian dollar support exports?

A 2015 Look at Global Trade examined exchange rate data (1996-2014) and Canadian trade data with Canada's top five export markets (the United States (U.S.), China, Japan, Europe and Mexico). Overall:

- A weak Canadian dollar does boost exports — but not in all instances.
- The response of export values to a change in the exchange rate takes more time in markets that are less established.
- The quick ("short-run") responses among Canada's major trade partners to a change in exchange rates are less important to overall export values than the long-term impacts.
- The more heavily concentrated exports are to a single export market, the more likely there will be a change to that product's export values in response to a change in the exchange rate.

Trade impacts of the Canadian dollar in Canada's top five export markets

Export values of live animals and manufactured food products to the U.S. are impacted almost immediately after a change in the loonie. The impacts to Canada's trade of these commodities last long-term, too. Exports of crops to the U.S. market, however, take slightly longer to adjust than other commodities, and over time show little response to changes in the USD-CAD exchange rate.

China's imports of Canadian goods have increased in recent years, and are less sensitive to changes in the exchange rate than are Canadian sales in other markets. Their imports of Canadian food manufacturing, while growing, are still relatively small and their imports of Canadian crops respond to other market forces, like income, more than they do to the exchange rate.

Canadian export values of both crop production and manufactured food products quickly adjust in Japan and Mexico to a change in the exchange rate – but over the long run, a change in the loonie only impacts these two markets' imports of manufactured food products.

Europe is a large importer of Canadian crops, and its import values are eventually impacted by changes in the euro-CAD exchange rate. The adjustment, while fairly slow, lasts over time. Canadian export values of food manufacturing to Europe, on the other hand, are still fairly small and unresponsive to changes in exchange rate values.

Currency fluctuations and the impacts on exports: What do we expect?

A decline in the value of Canada's currency is expected to lead to higher Canadian export values. The reverse is also true: an increase in the value of the Canadian dollar should lead to a decrease in export values.

How does it work?

1. Many agricultural commodities traded in global markets are priced in U.S. dollars (USD). When the USD appreciates relative to the Canadian dollar (CAD), those USD will convert into more CAD, even without a change in price. That brings a first boost to export values.
2. Importers can buy products from a number of competitors and will typically choose the lowest-cost supplier. A devaluation of Canada's currency will eventually lower the purchase price for buyers and improve Canada's competitive position in the global marketplace, potentially resulting in more exports.

Gross domestic product a key for Canadian exports

The gross domestic product (GDP) of each of Canada's major trade partners also matters to Canadian export values of agriculture and manufactured food products. In most cases, GDP matters more to increasing Canada's trade within those markets than does the exchange rate.

Maintaining Canada's leadership through innovation and productivity

Canada is renowned worldwide for the consistently high-quality, safe agriculture commodities and manufactured food products that are exported every year. Favourable exchange rates aren't the main determinant of Canada's competitiveness in the global marketplace, however: innovation, product quality and developing solid trade relationships have greater impact on Canadian trade flows.

Focusing on these while understanding the impacts of exchange rate fluctuations will ensure Canada upholds its reputation as one of the world's most trusted sources of food and maintain its role as a leading global exporter.

Canada's largest agriculture and food manufacturing export markets

This report examines Canada's export values of agriculture and manufactured food products to our five largest trade partners. Product categories are based on the North American Industry Classification System (NAICS).

They include:

1. Animal production and aquaculture
2. Crop production
3. Food manufacturing

The U.S. dominates as the largest market for exports of animal production and aquaculture with 86 per cent of total share of Canadian exports. Concentration is even higher for some sectors, increasing to 99 per cent of Canadian exports of cattle and hog production. The U.S. share falls to 71 per cent of Canada's exports of manufactured food products, but no other single market imports more than six per cent of Canadian exports. The greatest diversification of Canadian export markets occurs with crop production. The U.S. share falls to one-quarter of total Canadian exports.

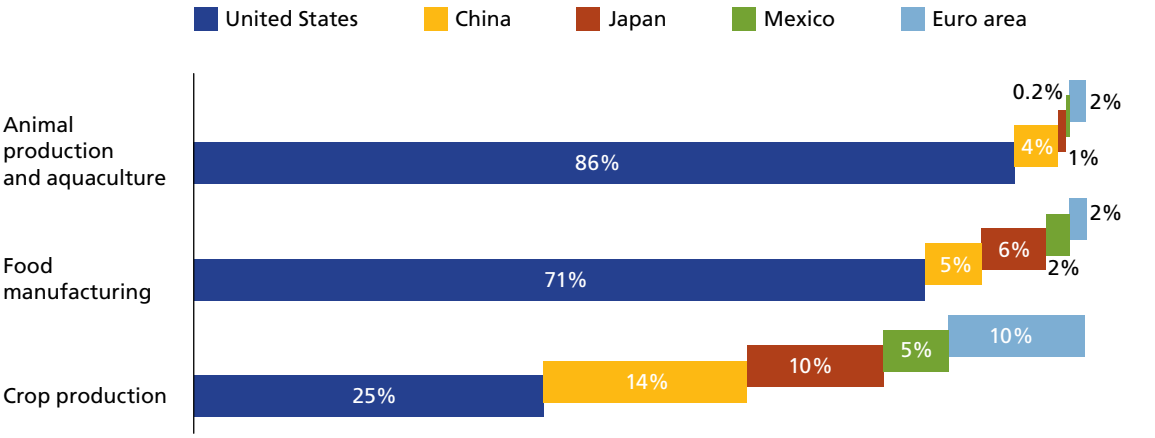
The United States plays another role in Canada's exports. Because so many agriculture commodities are priced in USD, the value of the loonie relative to the USD will be critical in determining Canada's agriculture and food manufacturing export values.

A note on the inclusion of euro area member countries

European imports of Canada's agriculture and manufactured food products are significant. These are only expected to grow with the Comprehensive Economic and Trade Agreement (CETA), which will likely be implemented over the next 12 to 24 months.

In this report, we defined Europe as the 19 member countries that use the euro (euro area). In 2015, countries in the euro area included: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Spain, Slovakia and Slovenia.

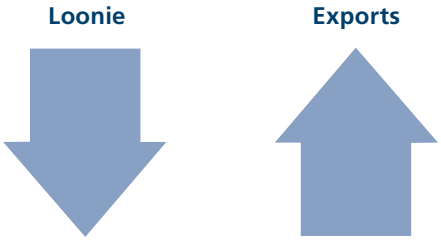
Figure 1: Market share of top five destinations for Canada's exports of food manufacturing, crop and animal production, 2014



Source: Industry Canada

A decline in the relative value of Canada's currency will effectively lower the cost of Canadian goods in importers' markets – resulting in both short-term and long-term adjustments. It's important to distinguish the short from the long-term impacts for agricultural markets, because agri-food supply chains are often characterized by significant lags between the dates of production and marketing decisions.

The analysis below distinguishes the speed of adjustment in export values from the size of the adjustment in those values, as a result of a change in the exchange rate.



Quick adjustments to Canadian export values in response to a change in the loonie

Some markets adjust quickly to a falling loonie with higher import values of Canadian goods.

Canada's exports of live animals are highly concentrated to the U.S. market (86 per cent of Canadian exports) and sales are priced in U.S. dollars. As a result, the change in value of those exports is almost instantaneous (results not shown).

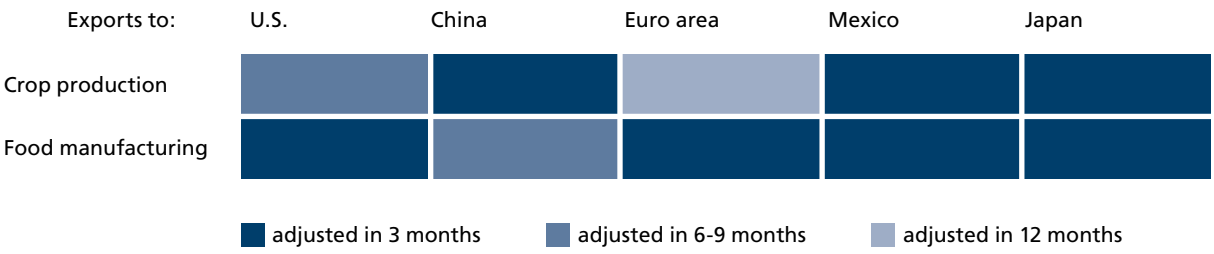
Export values of manufactured food products also tend to adjust quickly to changes in the relative value of the Canadian dollar (Figure 2). The speed of adjustment differs slightly from that of animal production export values as these exports aren't as concentrated in the U.S. market, which is the destination of 71 per cent of Canadian exports of manufactured food products. A significant adjustment occurs within three months with this category.

Adjustments in exports of crop production take more time. This slower adjustment period can be the result of different factors such as capacity constraints (i.e., available supply is fixed in the short term) or the existence of contracts between buyers and sellers.

Overall, Canada's export values adjust relatively quickly to changes in the value of currencies, with some differences in the speed of response among markets' imports of different commodities. Canadian export values of commodities highly concentrated to the U.S. market adjust more quickly than do the values of commodity exports to more diversified markets.

Despite these quick adjustments, the specific responses in Canada's five top markets aren't consistent enough to suggest such short-term impacts warrant the attention of Canadian exporters. The magnitude of the changes to Canada's export values over the long term are more important to monitor and plan for.

Figure 2: Short-term adjustments in the values of exports to Canada's top global markets



(Darker shades of blue in Figure 2 indicate a quicker adjustment in Canada's export values to that market.)

Source: FCC Agricultural Economics

The short and long of currency fluctuations

Export values should eventually climb in response to a weaker currency as importers buy more of the relatively cheaper product. But export values can also rise immediately following a currency depreciation – despite the fact that neither the volume of trade nor the price of exports may have changed.

How does it work?

Canadian export values are realized when a shipment leaves Canada, but the price of that shipment will usually have been specified in contracts and determined months before shipment. Exporters can receive higher revenues when they ship if the currency moves favourably between the time the contract is signed and before they deliver the shipment.

Say a U.S. buyer imports a Canadian commodity that is globally traded and priced in USD (e.g., wheat). At the time the contract is signed, the U.S. importer agrees to buy 100 tonnes of wheat for delivery in six months, at a price of US$200 a tonne. The price of the shipment is US$20,000 (100 tonnes at $200 a tonne). On the date the contract is signed, the USD-CAD exchange rate is 0.80. If the buyer paid at this time, the Canadian exporter would receive C$24,000.

In six months, when the shipment is made, the Canadian dollar has depreciated further to 0.75. The price at the moment the shipment is made is still US$20,000 (100 tonnes at $200 a tonne) as per the contract, but the Canadian exporter will receive C$25,000.

This simple example illustrates that timing of sales matters. We expect that, over time, export volumes (and therefore their values) will increase in response to a weaker currency because those exports will have become more competitive and importers will increase purchases.

A lower loonie increases export values to selected markets over time

The size of adjustment to Canada's export values in the top five markets depends on the market and the commodity. Over time, a declining dollar helps grow Canadian exports of:

- food production to the U.S., Mexico and Japan
- crop production to Europe
- live animals to the U.S.

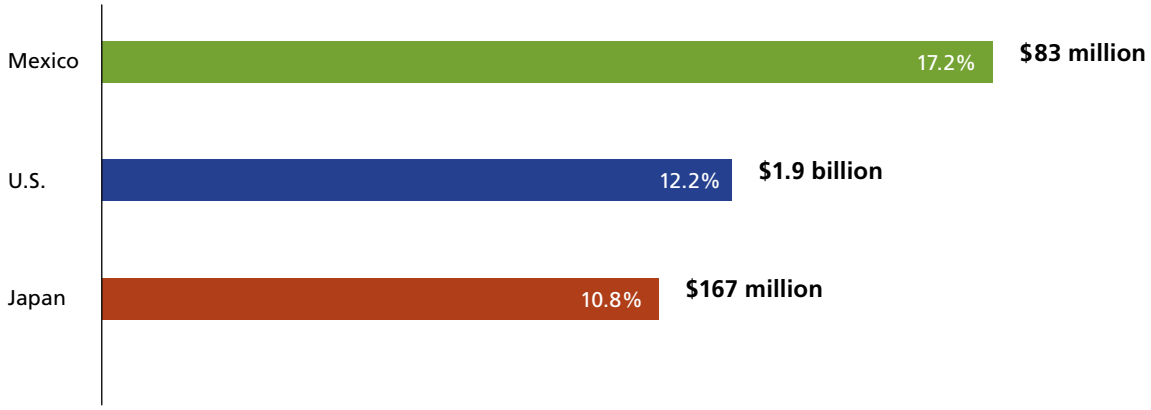
Exports of manufactured food products

Canadian export values of manufactured food products climb over time in response to a lower CAD versus the USD, the Mexican peso and Japanese yen (Figure 3).

The impact is strongest on Mexico's imports of Canadian manufactured food products. Historically, the Mexican market imports 17.2 per cent more manufactured food products on average for every 10 per cent depreciation of the Canadian dollar.

Based on Canada's average export values of 2010-2014, a 10 per cent weakening in Canada's exchange rate with Mexico would likely produce an increase of C$83 million in manufactured food exports. However, of all three markets where this positive impact occurs, Mexico has the lowest trade values of manufactured food products. In 2014, those amounted to C$570.6 million.

Figure 3: Canadian exports of manufactured food products climb when loonie falls to three top markets



Percent changes in export values of manufactured food products for a 10% depreciation in CAD. Figures at end of bars represent the expected gain in Canadian exports of manufactured food products to each market, based on the 2010-14 average export value.

Source: FCC Agricultural Economics

Changes to Canada's exports of manufactured food products to the U.S. are of the largest magnitude in absolute values. When the CAD declines by 10 per cent in value relative to the USD, values of our exports increase by 12.2 per cent on average. Based on the average export values of 2010-14, a 10 per cent fall in the USD-CAD exchange rate would produce an increase of C$1.9 billion. This isn't surprising, given the market accounts for 71 per cent of the world's imports of Canadian manufactured food products. Note that a CAD appreciation would have the opposite effect – a decline in exports to each of these respective markets.

Exports of manufactured food products to China and Europe were not found to change significantly in value over time when the Canadian dollar drops.

A change in the loonie has no significant long-term impact on China's imports of Canadian crop production or manufactured food products. In China, imports of Canadian manufactured food products have been growing at a rapid pace, a reflection of their growing income. At this stage of China's economic development, income appears to be the more important driver of increasing values of Canadian exports.

European imports of Canadian manufactured food products also appear less sensitive to fluctuations in the relative value of the euro and loonie. In this case, third-country pricing may help explain the absence of an impact on the values of exports to Europe. If the Canadian and U.S. dollars both depreciate against the euro, the overall value of European imports of Canadian manufactured food products may not change significantly in the long run.

Exports of crop production

Over time, Canada's exchange rate has had little influence on our exports of crop production to the three largest export markets (the U.S., China and Japan). Conversely, a lower Canadian dollar boosts our long-term export values of crop production to member countries of the euro area.

The diversification of Canada's crops and export markets may be one of the reasons. The U.S., while the largest importer of Canadian crops, is only one of many:

- Canada is the sixth-largest exporter of edible vegetables in the world, only 40 per cent of which go to the U.S.
- Roughly 20 per cent of our cereal exports go to the U.S. market.
- The U.S. falls from its customary top importer spot to the third largest market for Canadian oilseed exports behind China and Japan.

Exports of animal and aquaculture production

A lower Canadian dollar increases exports of animal and aquaculture production to the U.S.; a higher loonie decreases them. Canada is the world's largest exporter of cattle, with virtually all our exports going to the U.S. as either breeding stock or for processing.

In the long run, a lower loonie helps increase the value of our livestock exports primarily because we export the one commodity group to one market, using the currency of our trade partner.

The CAD also impacts imports

Much discussion around the loonie centres on exports. But adjustments to Canadian import values also occur as a result of changes in the loonie – impacting the competitive position of businesses in the domestic market.

When the loonie loses strength, as it has in 2015, Canadian imports of global goods become relatively more expensive. Each Canadian dollar is able to buy fewer units of foreign goods, which should lead to lower imports.

In response to changes in the value of the loonie against currencies of our major trading partners, the values of imports of agriculture or manufactured food products go through small adjustments in the short term. It takes six to 12 months for adjustments to register, with the notable exception of imports of animal production which adjust instantaneously.

Over the long term, the value of Canadian imports of China's manufactured food products alone respond to a movement in the exchange rate. A depreciating loonie makes our imports from China more expensive and lowers the degree of competition domestic food manufacturers face.

Growth in the GDP of top markets boosts Canada's export values

Exchange rates impact trade flows by lowering or raising the costs that buyers pay for imported goods. However, many other factors also influence the size and direction of trade flows.

Of all such factors, the purchasing power of buyers in foreign markets may be the most critical. Gross domestic product (GDP) is usually used as a proxy measure of purchasing power. GDP is a measure of a country's total economic activity. Economic growth as measured by GDP drives consumption and demand for commodities and food produced elsewhere.

The success of Canada's exports of agriculture and manufactured food products relies on having access to global markets with strong economies. In fact, Canada's exports are generally more sensitive to fluctuations in an export market's GDP over time than they are to fluctuations in the exchange rate. An increase in the GDP of a market is likely to increase Canadian exports to that market.

This is the case, regardless of a country's stage of economic development. Even in the case of a well-established market like the U.S., Canada's export values of agriculture and manufactured food products are still a function of GDP growth. The size of the increase, however, depends on a number of factors and differs among Canada's top export markets.

The International Monetary Fund projects 2016 GDP growth (in %) among Canada's trade partners as:

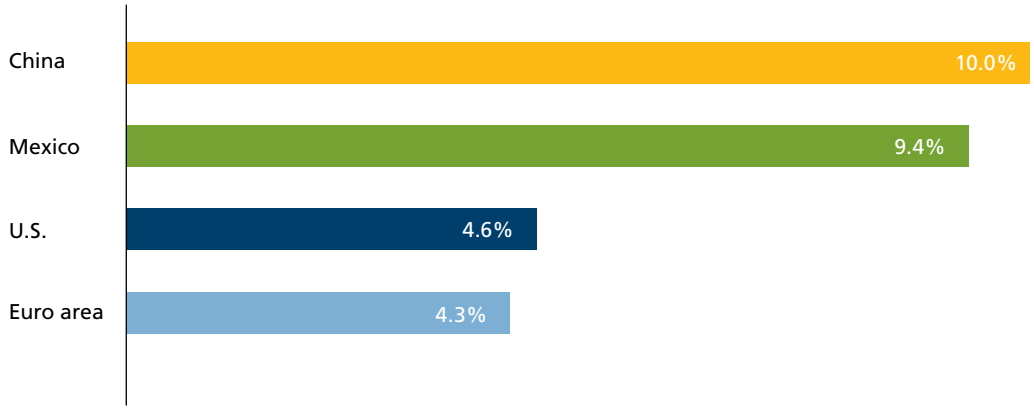
Japan	1.2
United States	3.1
Euro area	1.6
China	6.3
Mexico	3.3

China and Mexico are expected to outpace the U.S., euro area member countries and Japan in GDP growth, which will translate into stronger growth of their imports.

An increase in the GDP of four out of five major markets' economies boosts Canadian exports of crops: only in Japan is there no impact to imports of Canadian crops when their GDP falls or increases. Of Canada's top five markets, the two emerging markets will grow their import values of Canadian crop production (Figure 4) and manufactured food products (Figure 5) the most in 2016.

Figure 4 illustrates the increases possible to crop production export values following an increase in the GDP of Canada's export markets. Using 2014 export values as an example of what could happen, Canadian values of crop exports to the U.S. might grow by 4.6 per cent, or C$272 million, in 2016, given a 3.1 per cent increase in GDP. China's expected GDP growth could spur an additional 10 per cent, or C$343 million, worth of crop exports in 2016, based on their GDP growth of 6.3 per cent.

Figure 4: 2016 Canadian exports of crop production to emerging markets expected to benefit from projected GDP growth



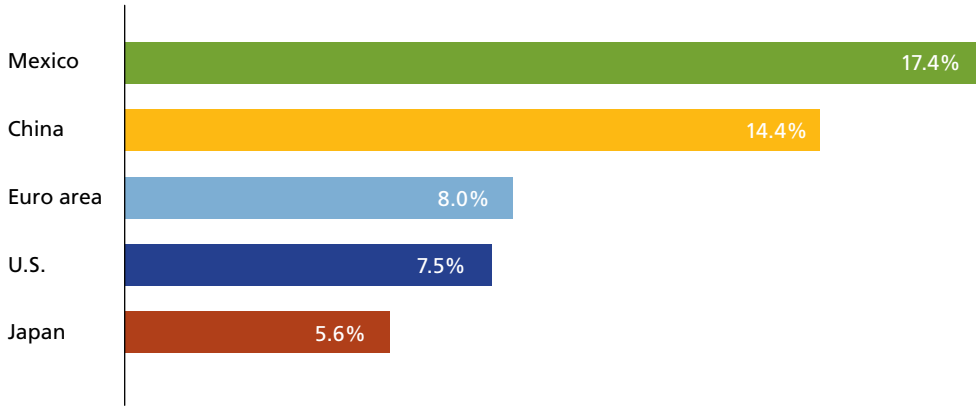
Predicted growth in Canada's exports of crop production for 2016, in reponse to GDP growth projections in export markets

Source: IMF World Economic Outlook; FCC Agricultural Economics

Figure 5 illustrates the increases possible to food manufacturing export values following an increase in the GDP of Canada's main export markets. Using 2014 export values as a baseline, Canadian values of food exports to the U.S. might grow by 7.5 per cent, or C$1.4 billion, in 2016, given a projected 3.1 per cent increase in GDP.

China's expected GDP growth could spur an additional 14.4 per cent, or C$210 million, worth of food exports in 2016, based on their GDP growth of 6.3 per cent. Despite the fact that China's expected growth rate is almost double that of the U.S. expected GDP growth in 2016, Canadian exports of food manufacturing to the U.S. market far outstrip those to any other market and stand to gain the most from increases to economic growth south of the border.

Figure 5: GDP growth in emerging economies expected to lead gains in Canada's exports of manufactured food products



Predicted growth in Canada's exports of manufactured food products for 2016, in response to GDP growth projections in export markets

Source: IMF World Economic Outlook; FCC Agricultural Economics

The drivers of fluctuations in the Canadian dollar

Currency fluctuations impact Canadian exports of agriculture and manufactured food products in the long run. But what are the drivers of changes in the loonie?

The impact of oil

Oil exports are often used as a barometer for the health of the Canadian dollar. In 2014, Canada's oil exports totalled C$114 billion, of which more than C$110 billion went to the U.S. Canada exports millions of barrels of oil a day there.

The higher the demand for oil (and the higher its price is), the higher the demand for Canadian dollars as exporters need to convert the proceeds of sales from USD to CAD. That demand pushes up the value of the Canadian dollar. The value of the Canadian dollar and the price of oil often move together (Figure 6).

Figure 6: Weaker oil prices and low interest rates have pushed the loonie lower

Source: Federal Reserve Bank of St. Louis, Economic Research

Between 2007 and 2015, the CAD-USD exchange rate has been volatile, with the Canadian dollar gaining value against the U.S. dollar between 2009 and 2012. It has been weaker recently, following a downward trend that began in the middle of 2012. The CAD largely mirrored changes in the price of oil during these periods.

The impact of interest rates

Changes in interest rates by the Bank of Canada or the U.S. Federal Reserve also have an impact on the Canadian dollar relative to the U.S. dollar.

When interest rates in one country rise, investors will move capital to where they will get the highest return. That means there will be more demand for one currency relative to the other. That will drive up the value of the currency where interest rates are moving higher.

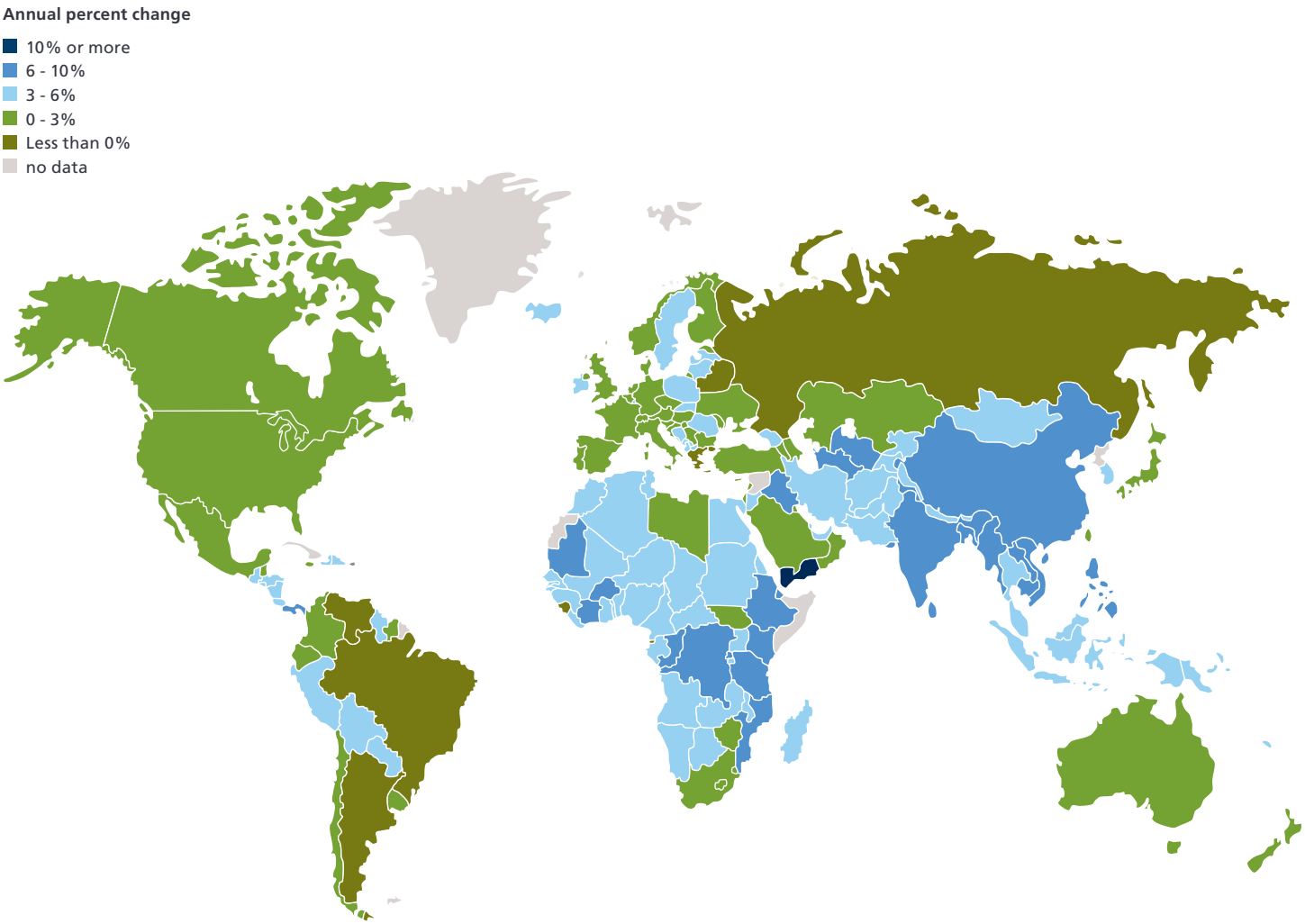
What drives the value of the Canadian dollar? It's mostly supply and demand.

The opportunities ahead: Economic growth in emerging markets projected to boost food demand

Generally speaking, wealthy countries trade more. They also export and import more expensive food products. Global wealth has traditionally been concentrated in the developed world, but since 2000, global GDP growth has mostly come from emerging markets. The average GDP growth rate of developed economies was 1.8 per cent in 2014, while developing countries recorded a growth rate of 4.6 per cent. It's a trend likely to continue.

Figure 7: IMF projections of global GDP growth in 2016

Source: IMF, Data Mapper



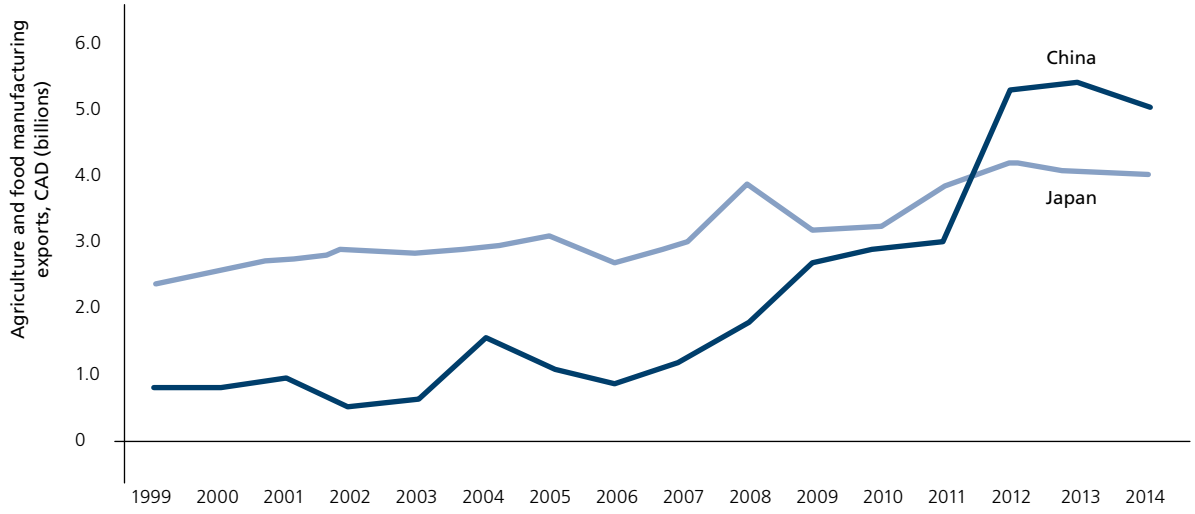
Chinese currency hub: potential for higher trade flows

In March 2015, Toronto became home to the first trading hub in the Americas for China's currency, the renminbi (RMB). There are other RMB hubs established in large cities, such as London, Frankfurt, Sidney and Seoul. China already accounts for one of the largest shares of Canada's exports of agriculture and manufactured food products. The Canadian hub should allow Canadian businesses to expand further into the growing Chinese market by facilitating the conversion of CAD and RMB. It will mean savings for businesses in Canada and China that no longer need to convert RMB or CAD into USD before carrying out their transactions.

China is a good example of this emerging trend. China's GDP is projected to grow at a rate below 7.0 per cent annually in 2015 and 2016. Despite some of the current turbulence in the Chinese economy, it is nevertheless impressive growth compared to a country like Japan, where the economy is expected to expand by 1.0 per cent in 2015 and 1.2 per cent in 2016. All other things being equal, China's appetite for Canadian exports of agriculture and manufactured food products will continue to grow faster than Japan's.

China's growth in imports of all three commodity groups from Canada has been spectacular in the last 15 years. In 2012, China surpassed Japan as Canada's second largest export market for crop production and manufactured food products (Figure 8).

Figure 8: China exceeded Japan as Canada's second largest importer of crop and food manufacturing



Source: Industry Canada

Canada's trade with India

India is Canada's fifth largest single-country market for crop production exports. It has held this spot since 2012, and over the last 10 years has increased its imports of Canadian crops by 432 per cent.

India is expected to remain an important market for Canada. In 2014, it was the second largest importer of Canadian legumes (behind the United States) and the largest single-market importer of Canadian lentils and peas.

In 2015, India's economic health prospects appear particularly bright. Low oil prices have helped improve the Indian economy and some official statistics suggest that, at 7.5 per cent, it will be the fastest-growing economy on the planet. If things continue, it could grow to become one of the world's three largest economies with the largest population within one generation.

Other emerging markets also demonstrate potential for a growth in demand of both agriculture commodities and food products. In 2016, India may very well lead all major importers of agriculture and food manufacturing with an expected and impressive GDP growth of 7.5 per cent.

The other two countries in the BRIC lineup, Brazil and Russia, are not projected to show the same rates of economic growth. Brazil appears heading for a slight improvement in 2016 over its GDP growth in 2015, but will still be a modest one per cent. Russia's GDP is expected to contract a further 1.1 per cent in 2016, after suffering a 3.8 per cent loss in 2015.

Chile and Peru, both members of the Trans Pacific Partnership trade deal, are projected to record more than three per cent growth in the coming year. Chile was the world's tenth largest agriculture exporter in 2014. Peru, South America's fastest growing economy, is looking for foreign investment to help boost improvements to its infrastructure.

Trade is vital to the health of Canadian agriculture and agri-food sectors

In 2014, Canada's agriculture and agri-food system (including input and service supplier industries, primary agriculture, food, beverage and tobacco processing, wholesale and retail food industries, and food service) provided 2.3 million jobs and contributed C$108.2 billion (6.6 per cent) to Canada's gross domestic product (GDP).

With production outpacing domestic consumption, Canada must export a large proportion of agriculture and food production. For instance, Canada produces over 28 million metric tonnes (Mt) of wheat annually, of which approximately 8 Mt is consumed or used domestically in industrial and feed uses. Canada also produces approximately 2 Mt of pork annually, of which 1.2 Mt, or more than 60 per cent, is exported.

Trade is vital for most agriculture and agri-food sectors. Factors impacting trade – like GDP growth and exchange rate changes – are key for Canadian producers and businesses to anticipate and understand so business strategies can be adapted to evolving market conditions.

Canadian agriculture producers and agri-food manufacturers – among the world's largest exporters

Canada ranks as one of the world's largest exporters of agriculture and agri-food (Figure 9), despite a relatively small population of 34.8 million. Canada is the fifth largest exporter of agriculture and the eighth largest exporter of agri-food.

Canadian consumers and businesses also purchase many food products that can't be produced here. With strong purchasing power and an appetite for fresh fruit and vegetables year-round, Canada is the world's sixth largest importer of both agriculture and agri-food.

Canada's overall trade values in 2014, including both exports and imports, totalled C$83.3 billion, or 3.8 per cent of the world's total agriculture and agri-food trade.

Figure 9: World rankings of agriculture and agri-food imports and exports[1]

Rank	1	2	3	4	5	6	7	8	9	10
AGRICULTURE										
	EA**	USA	China*	Brazil	**Canada**	India	Australia	Argentina	Mexico	Chile
Ag export values	118.60	77.74	34.24	29.76	**28.17**	20.47	13.90	12.62	12.13	11.59
	EA**	China*	USA	Japan	UK	**Canada**	Mexico	Egypt	Sweden	Poland
Ag import values	143.08	77.09	49.05	29.99	19.09	**11.98**	10.24	8.15	7.11	6.37
AGRI-FOOD										
	EA**	USA	Brazil	China*	UK	Malaysia	NZ	**Canada**	Thailand	Poland
Agri-food export values	306.11	62.12	40.39	36.00	25.79	22.40	20.74	**19.75**	19.34	18.14
	EA**	USA	China*	UK	Japan	**Canada**	Mexico	India	Australia	Poland
Agri-food import values	245.02	78.96	52.26	46.18	34.02	**23.43**	14.53	13.26	10.34	9.92

Source: UN Comtrade

2014 world rankings, USD (billions)

[1] Agriculture includes HS codes 01, 03, 06, 07, 08, 10, 12, 14. Agri-food includes HS codes 02, 04, 09, 11, 13, 15, 16, 17, 18, 19, 20, 21, 22

** China includes Hong Kong and Macao*

*** EA includes Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Cyprus, Estonia, Greece, Latvia, Lithuania, Malta, Slovakia, and Slovenia*

The euro area member countries are collectively by far the world's largest trader. Its single currency facilitates trade between its members, many of whom rank highly as individual exporters. Countries outside the euro area but within the European Union also appear on the list of top 10 traders. The United Kingdom, Sweden and Poland further demonstrate the magnitude of European trade volumes.

The U.S. is an economic powerhouse in agriculture and agri-food trade as it is the world's top single-country agri-food importer and agriculture exporter. It is second only to euro area member countries as an exporter of agri-food and second to China as an importer of agriculture commodities.

China is the world's third-largest agriculture exporter and second only to the euro area member countries in agriculture import values. Driven by an increasingly wealthy population, its food manufacturing imports have grown 68 per cent over the last five years alone. Dairy and preparations of cereals, flours, starch and milk have seen the greatest increases in imports.

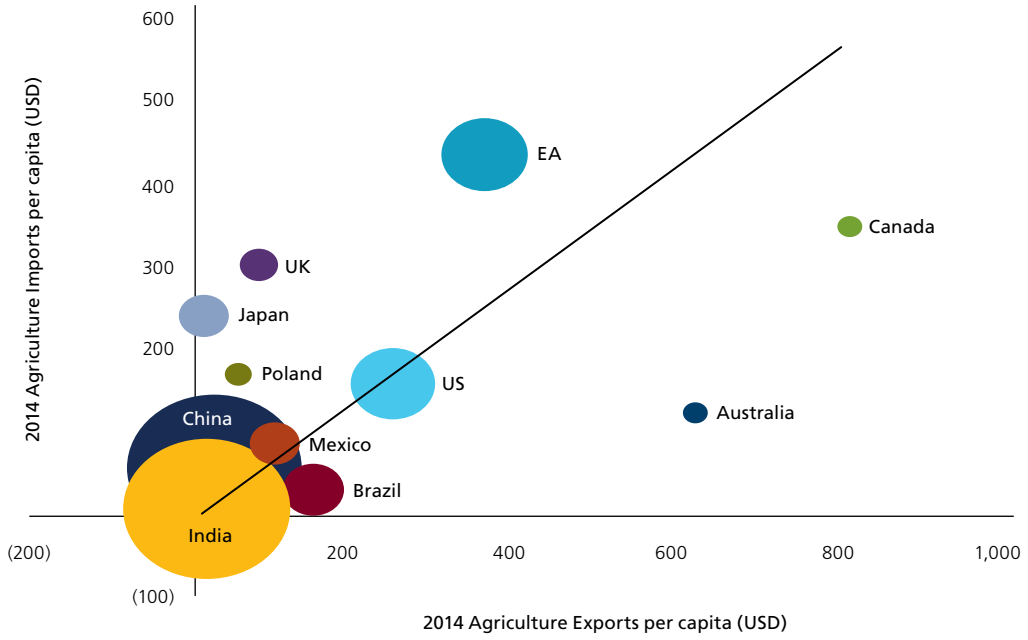
Per capita rankings reveal the strength of Canadian exporters

Canada trades more agriculture commodities on a per capita basis than other top 10 traders – about C$1,153 per person in 2014 (Figure 10). Our status as a strong net exporter on a per capita basis illustrates the importance of foreign markets for Canadian agriculture and agri-food.

Australia, one of Canada's competitors in beef, cereals and oilseeds export markets, also has a small population. But it is a smaller per capita agriculture trader as 2014 agriculture exports and imports are lower than Canada's.

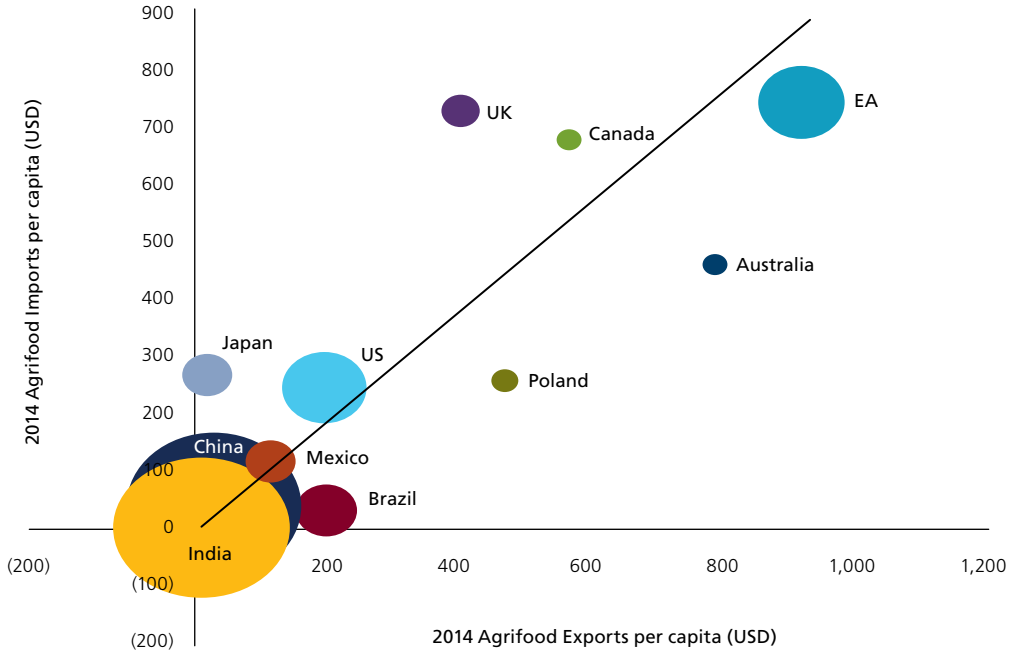
Focusing strictly on agri-food trade, however, paints a slightly different picture. Australia is a larger agri-food trader on a per capita basis than is Canada, who is a net importer. The euro area member countries dominate the agri-food trade landscape. They're both the largest overall trader of agri-food, and the largest importer and exporter on a per capita basis.

Figure 10: Canada – the world's largest per capita agriculture trader



Source: UN Comtrade, US Census Bureau

Figure 11: Europe dominates global food manufacturing trade



Source: UN Comtrade, US Census Bureau

A higher Canadian dollar lowers border protection of Canada's dairy sector

The value of the Canadian dollar also impacts the competitiveness of sectors in which Canadian producers compete with imports. When the value of the loonie rises, the price of imported goods falls for Canadian buyers. In Canada's dairy sector, a higher Canadian dollar also means reduced effectiveness for the tariffs that shield the Canadian market from imports.

How does it work?

Within Canada's supply-managed dairy sector, only specified amounts of dairy products can be imported tariff-free. Imports that exceed those predetermined volumes are taxed at the border. Canada's tariffs on foreign dairy products generally range between 200 and 300 per cent.

Canada's domestic prices of dairy products are higher than world prices. To avoid entry of foreign products in the Canadian market, the "landed" price of imports must be higher than the domestic price. For instance, the landed price of imported butter is the world price, converted into Canadian dollars, plus the applied tariff and the transportation cost to bring the butter to Canada.

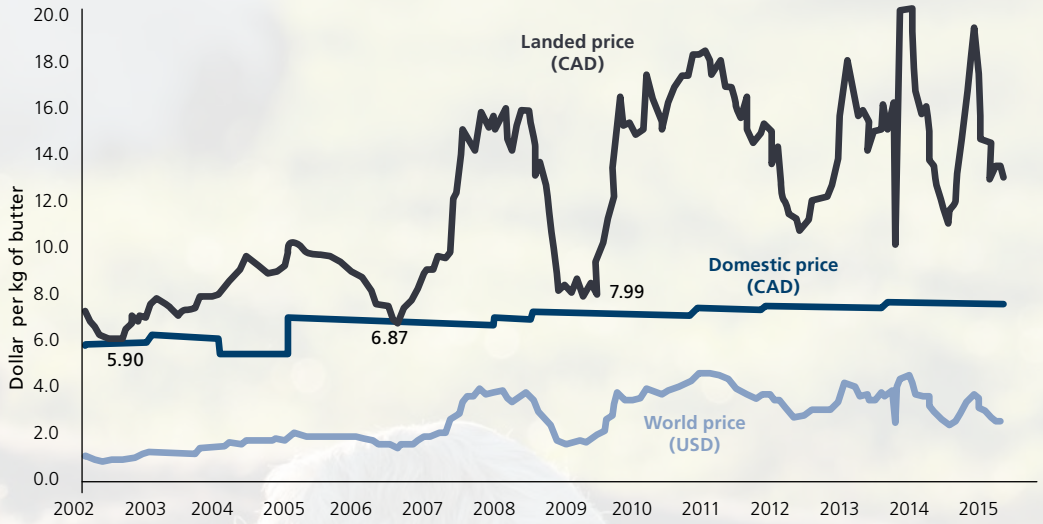
Two things need to be monitored closely:

1) The world price of butter: If it falls, the landed price will also fall. As a result, there won't be as big a difference between the domestic and landed prices.

2) The Canadian dollar: A stronger loonie will make imported products cheaper and could potentially result in imports above the tariff-free volume if the landed price of butter falls below the domestic price.

The landed price of imported butter was roughly the same as the domestic price for periods in 2002, 2006 and 2009 (Figure 12). The narrow difference between the landed and domestic prices of butter in late 2006 was mostly the result of the appreciation in the Canadian dollar. The world price then was fairly constant. Conversely, the tighter gap between the two prices in early 2009 was mostly the result of a significant drop in the world price.

Figure 12: Butter landed prices generally higher than support prices with rare exceptions



Source: FCC Agricultural Economics

Challenges in the global marketplace

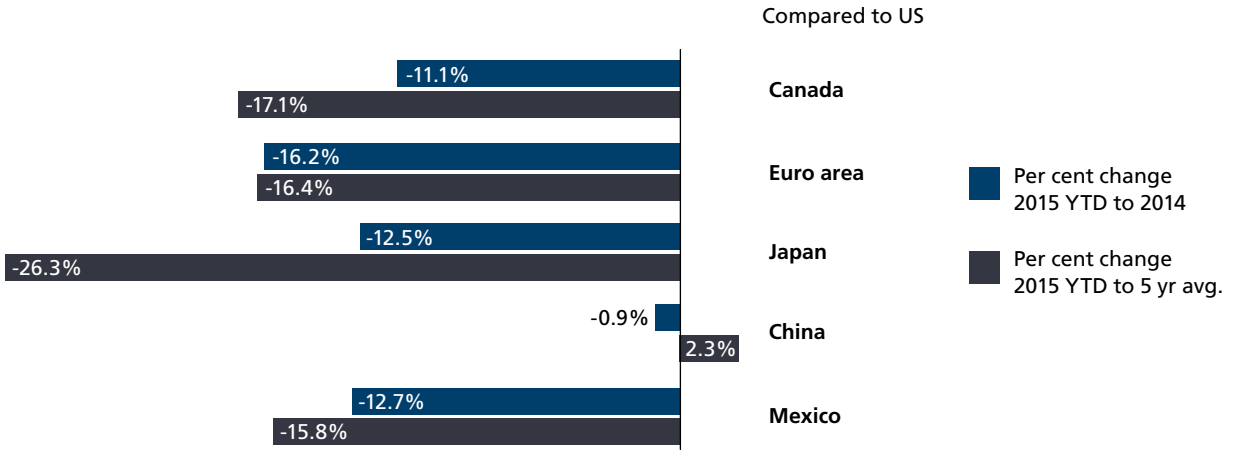
In the years to come, Canadian producers and food manufacturers can expect to witness a growing demand for agriculture and manufactured food products from emerging markets. Diversifying our exports into new markets is one of the best ways to mitigate the risk of potential disruptions to the U.S., Canada's largest export market.

Market diversification will be a challenge in the face of stiff competition. The U.S. presence in global markets is currently extensive, reflecting an evolving trade position toward new markets that has grown over the last 20 years. According to a recent United States Department of Agriculture (USDA) study, Canada's 2014 exports of agriculture commodities and agri-food products to the U.S. comprised over half (51 per cent) of total Canadian exports, while 15 per cent of U.S. exports landed in Canada.

How does Canada's currency value stack up against other currencies?

Exports and imports happen in a world market where buyers have options to source product from a number of different suppliers. Each exporting country has its own exchange rate and patterns of currency movements it shares with the importing country. As one exporting country's currency appreciates, its competitors may become more competitive, if their currencies are priced relatively lower. Because of this, Canada's trade flows must be understood in the broad context of a basket of currencies.

Figure 13: Currencies of Canada's major trading partners losing more value against USD



Source: Pacific Exchange Rate Service

The strength of the USD and its movements relative to each competitor's currency point to the importance of analyzing currency movements in a global context. Compared to Canada, the euro area member countries and Mexico have seen their currencies depreciate further in 2015 against the USD (over the 2014 average). The Chinese currency has only slightly depreciated against the U.S. dollar in 2015, although recent actions by Chinese authorities suggest that further depreciations are likely.

Over time, these currency patterns can impact attempts to diversify exports of Canadian agriculture and manufactured food products.

Conclusion

Trade flows are driven by interactions among buyers and sellers located in different countries. They are the result of how prices compare among suppliers and the relative purchasing power of different buyers. The value of the Canadian dollar certainly plays a role in shaping trade flows of Canada's agriculture and manufactured food products. But it's not always the most important factor.

Conventional wisdom suggests that a lower Canadian dollar is good for exports. While this is indeed true, it is not always as significant a factor as we might expect. In the short term, export values are boosted by a lower currency. But generally, a low currency value establishes a lasting and significant impact over time in sectors for which our exports are highly concentrated to one market.

The potential of a lower Canadian dollar to create a more competitive Canadian trade position can be mitigated by a host of factors, such as movement in the currency of other exporters. Export market diversification – as in the case of Canadian exports of crop production – also lessens the importance of a lower value in the CAD in boosting export values. This is great news for innovative producers seeking new export markets, especially when the dollar starts to rise.

The economic health of the importing country is more likely to boost or depress Canadian exports of agriculture and manufactured food products. Canadian export values show far greater sensitivity to changes in the GDP of each export market. Increasing wealth among developing countries has changed the global trade landscape – and will continue to do so, as new producers, exporters and export destinations appear in emerging markets.

A strengthening U.S. economy over the next year may help boost Canadian exports of agriculture and manufactured food products. The strength of the USD will also drive up the price of U.S. commodities in global markets, opening up potential for broader exports of Canadian goods which will benefit in the long term from the lower CAD. Overall, the current U.S. economic strength will translate into higher additional trade values for Canadian exporters shipping to the U.S.

Canadian crop exports to China, Japan and Mexico won't be impacted much by the lower CAD in 2016, even if it continues to slide further. However, the expected GDP growth in the two emerging markets could help increase Canadian export values of both crops and manufactured food products in each market over the next year. Despite reports of a weakening Chinese economy, it continues to grow at a pace that will support higher values of both types of Canadian exports. Exports of manufactured food products may also increase in 2016 to Japan on the basis of their GDP growth, albeit at a slower rate of growth.

Canadian exports of crops to member countries of the euro area should increase next year as the dollar continues to slide and the European economy shows signs of improvement. Crop prices are expected to remain low in the next marketing year due to a glut in global supply, and if the euro continues to fall faster against the USD than against the CAD, Canadian crop export values may see even greater benefit. As Canada's only major crop export market sensitive to exchange rate fluctuations, Europe is also likely to increase imports when CETA comes into force.

Canadian exporters need to focus on leveraging their competitiveness for the long run. Short-term fluctuations are part of the regular business cycle and are difficult to anticipate. Ensuring that exports meet the needs of importers and focusing on productivity and innovation will help Canadian agriculture and food manufacturing exporters maintain their leadership roles in the global marketplace.

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