

ECONOMIC VIEWPOINT



Canada's International Trade Facing Numerous Challenges

Canada's trade balance has deteriorated substantially since the early 2000s, calling attention to the significant and ongoing transformations. Considerable effort has been made in recent years to deal with the structural changes. Among other things, the Canadian government has entered into numerous trade agreements, and measures are in place to facilitate interprovincial trade. The service sectors also seem to be taking on more and more weight in foreign trade. However, these adjustments will take time to roll out completely. The outlook is encouraging over the medium range, but export growth could remain erratic in the coming quarters.

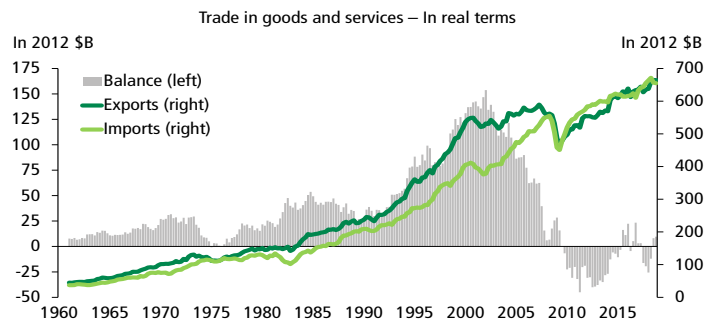
Canadian international trade is in upheaval. The surge in protectionism is hitting especially hard, as the governments of the three countries have not yet ratified the new Canada–United States–Mexico Agreement (CUSMA). Then there are the adverse effects of the U.S. tariffs imposed on Canadian steel and aluminum exports, and the Canadian tariff reprisals on some goods from the United States. The last few months have seen some additional difficulties, as the problems associated with oil and gas sector transport constraints becoming increasingly pressing.

A Slow Decline

First of all, it is clear that Canada's international trade is not what it used to be. Canada's trade balance improved slowly between the early 1960s and early 2000s, peaking at a surplus of \$154B (in 2012 constant dollars) in the first quarter of 2002. Notably, a net improvement was recorded after the first Canada–U.S. free trade agreement came into force in 1989, followed by the North American Free Trade Agreement (NAFTA) in 1994 (graph 1).

As of the early 2000s, however, growth in Canadian exports hit a wall for several years. Combined with the uptrend in imports, this triggered a net erosion in the trade balance. On the heels of the Great Recession of 2008–2009, Canada ended up in a deficit position, a situation it is still struggling to get out of. Among other things, the volume of non-energy merchandise exports has not really made any major gains since the start of the 2000s (graph 2). Today, it is not much above where it was before the Great Recession of 2008–2009. However, the last few years

GRAPH 1
The trade balance has been almost zero for several quarters



Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 2
Energy product exports are up although the other sectors are stagnant



Sources: Statistics Canada and Desjardins, Economic Studies

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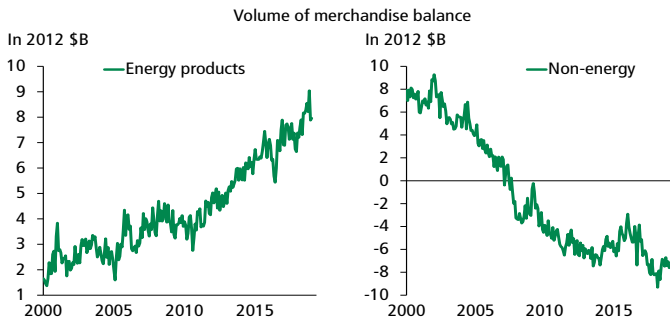
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NOTE TO READERS: The letters k, M and B are used in texts and tables to refer to thousands, millions and billions respectively.

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have been much better for energy product exports, which are showing a solid uptrend. The trade in energy products is posting a growing surplus; however, this is being offset by a net erosion in the balance of trade in goods excluding energy (graph 3). What happened?

GRAPH 3
The surplus in the trade in energy products is offset by a deficit in the other sectors



Sources: Statistics Canada and Desjardins, Economic Studies

Major Structural Changes Are Underway

The struggles that exports faced during the 2000s seem to be fairly specific to Canada, as global trade expanded substantially during that period (graph 4). Moreover, the volume of U.S. imports of goods and services increased 48% between the end of 1999 and the end of 2007. In comparison, the volume of Canadian goods and services exports gained a total of just 9% during that period, a sharp contrast. The anaemic export growth also led to a substantial decrease in Canada’s international trade openness (graph 5), which went from 41% in 2000, the highest rate among G7 nations, to just 33% in 2018, which is around average for the G7.

The transportation sector is largely responsible for the difficulties in non-energy exports. Canada’s auto sector has been in upheaval for several years, with numerous plant closures, among other things. In 2018, Canada produced 2,025,794 motor vehicles, well below the historic record set in 1999 with 3,056,983. Unfortunately, the downtrend is not over, given the news that an Oshawa plant is shutting down. The aviation sector is also slowing substantially: since the end of 1999, its output growth has been about one third that of the overall Canadian economy.

That being said, the difficulties in exports are not restricted to these two industries. Nearly all activity sectors have seen slower growth since 2000 (graph 6). Clearly, other factors are involved.

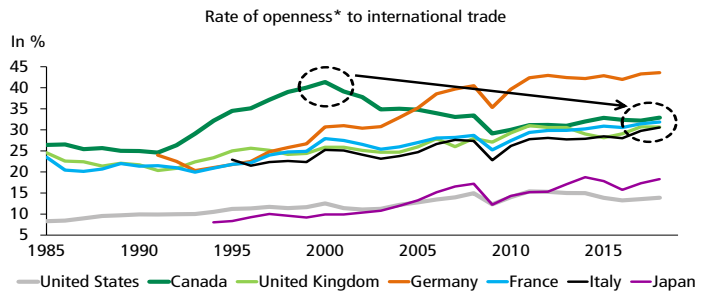
On one hand, many Canadian businesses clearly benefited from free trade with the United States and Mexico, substantially increasing their exports in the 1990s. However, the easiest gains

GRAPH 4
The stagnation of Canadian exports has not been observed in world trade overall



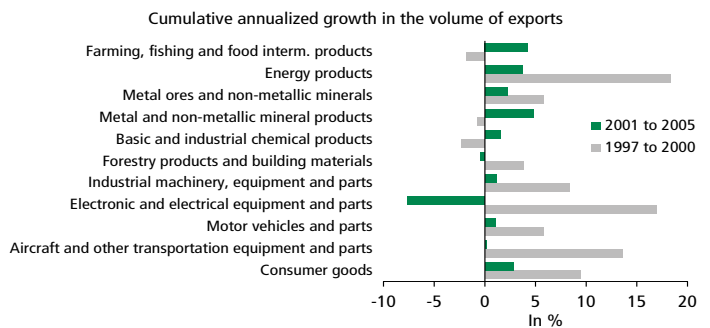
Sources: World Trade Organization, Statistics Canada and Desjardins, Economic Studies

GRAPH 5
Canada, which had been one of the most open economies, is now close to average among the G7 nations



* Corresponds to the average of exports and imports in relation to GDP. Sources: Organisation for Economic Co-operation and Development and Desjardins, Economic Studies

GRAPH 6
Export growth slowed as of the 2000s in nearly all sectors



Sources: Statistics Canada and Desjardins, Economic Studies

to make were made fairly quickly, and Canadian export growth stabilized as of the early 2000s.

On the other hand, Canadian exporters are facing greater competition in the international markets. For one thing, China’s entry into the World Trade Organization (WTO) in 2001 disrupted global trade and value chains substantially. In this context,

Canada's inability to make productivity gains has been a heavy drag on its competitiveness and foreign trade in recent years. Canada has lost market share in the last few years, particularly in the United States. Canada's relative weight in U.S. goods imports has declined substantially in the last few years (graph 7).

GRAPH 7
Canada is facing heavy competition in the U.S. market



Sources: U.S. Census and Desjardins, Economic Studies

Lastly, global trade has also been levelling off somewhat in the last while. As the Bank of Canada's Governor mentioned in a recent [speech](#), some global value chains have been simplified, and the fragmentation of manufactured products has reversed somewhat. Trade intensity has lessened, prompting slower trade growth worldwide.

It is, of course, hard for Canada to do well under such conditions. Thankfully, international trade is changing rapidly, and several factors allow us to be optimistic about the future.

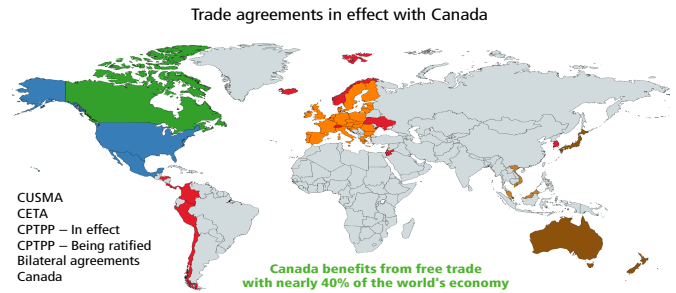
Better Diversification Is the Key to Success

Substantial efforts have been made in recent years to improve Canadian international trade's geographic diversification and lessen dependence on the U.S. market. Among other things, Canada has entered into numerous trade agreements. In addition to refreshing NAFTA via CUSMA, the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union came into force on September 21st, 2017, while the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) between Canada and ten other countries in the Asia-Pacific¹ area has been in force since December 30. Factoring in its other trade agreements, Canada currently benefits from a free trade area that represents nearly 40% of global economy (graph 8). This puts Canada in an enviable situation on the global landscape.

Although it should take a few more years before Canada can capitalize fully on this advantage, the benefits of better

¹ Australia, Brunei, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam.

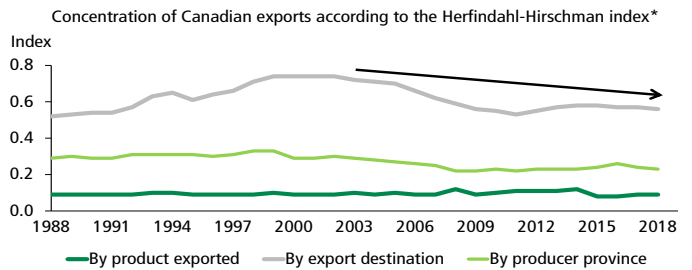
GRAPH 8
Canada has numerous trade agreements



CUSMA: Canada–United States–Mexico Agreement; CETA: Comprehensive Economic and Trade Agreement; CPTPP: Comprehensive and Progressive Agreement for Trans-Pacific Partnership
Sources: www.mapchart.net and Desjardins, Economic Studies

diversification should have an increasing impact. The trend toward better geographic diversification for Canadian exports observed since the beginning of the 2000s should persist,² and even intensify (graph 9). Some of the provinces, including Ontario and Quebec, are also seeing better diversification, depending on the type of good exported, even though the energy-producing provinces have seen their sector diversification erode in the last few years (graph 10 on page 4). However, there is still some way to go on diversification, depending on the product, and it will require consistent effort.

GRAPH 9
Canadian exports are a little more diversified

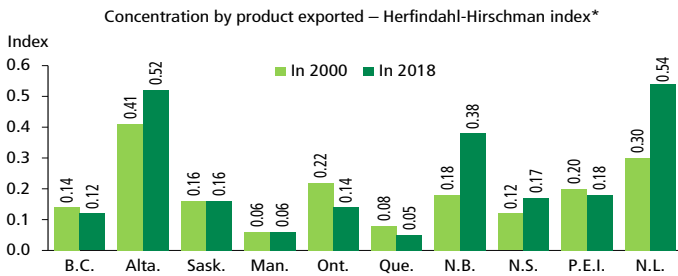


* Uses values between 0 and 1. A value close to 1 (maximum concentration) indicates a very high concentration for the product (or market). A value close to 0 indicates a more homogeneous breakdown of exported products (or markets).
Sources: Statistics Canada and Desjardins, Economic Studies

Other avenues are also being considered. The federal government and provinces recently showed strong interest in streamlining and expanding interprovincial trade to further reduce Canada's dependence on international trade. The numerous regulatory, administrative and legislative constraints on interprovincial trade have caused many companies to favour international markets for their business. Interprovincial trade's relative weight in provincial imports and exports hit a historic low

² Exports or a market are well diversified when they have a Herfindahl-Hirschman index below 0.15.

GRAPH 10
Exports are more diversified in some provinces



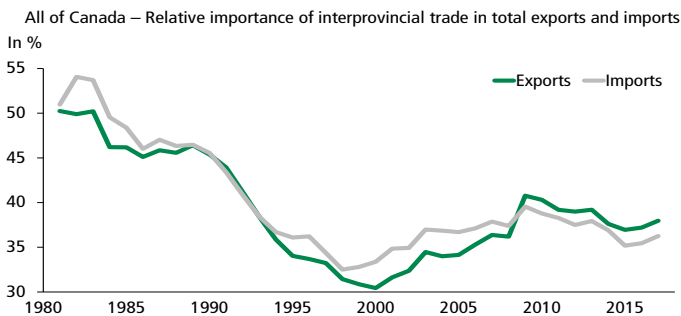
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Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 12
Service exports are growing faster than goods exports



Sources: Statistics Canada and Desjardins, Economic Studies

GRAPH 11
Trade between the provinces remains relatively low



Sources: Statistics Canada and Desjardins, Economic Studies

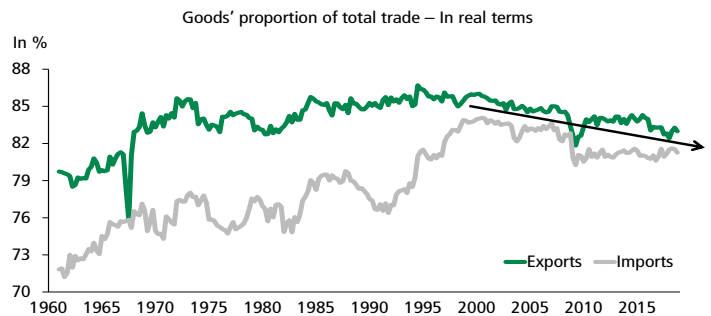
around the new millennium (graph 11). Although it has improved a little since then, interprovincial trade's share remains fairly low in comparison with where it was at the start of the 1980s. This means there's room to make major gains there in the years to come.

Another major change involves the role of services in Canada's international trade. Like most other industrialized countries, Canada's economy is increasingly based on the service sectors, which accounted for 70.2% of real GDP in 2018, compared with 65.6% in 1997. It therefore seems natural for services to have a growing weight in Canadian international trade. Growth in the export of services has also been well above growth in goods exports in the last few years (graph 12), helping reduce Canada's dependence on the international trade in goods (graph 13). That being said, the growth potential for services remains very high and it is in Canada's best interests to keep developing trade in these sectors.

A Promising Future

The many changes now underway within Canada's international trade are encouraging. It takes a while for this kind of upheaval to play out, but the recent evolution points to a rosy future for Canada's international trade.

GRAPH 13
The relative weight of goods in international trade is down



Sources: Statistics Canada and Desjardins, Economic Studies

Among other things, better geographic and product diversification should make exports less vulnerable. Clearly, due to geography, the United States will always be Canada's leading trade partner, but it would be desirable to keep reducing our exports' dependence on a single destination. In this context, the new trade agreements are wonderful news. That being said, to get the most out of the new agreements, Canada has to be competitive in international markets. A lot remains to be done in this area given the country's low productivity growth rate. This will be a big challenge for the next few years.

Waiting for these changes to go forward, the outlook for Canadian export growth will be uncertain in the coming quarters. Protectionism and the energy sector's problems will remain major near-term curbs. Still, global demand, especially south of the border, should keep increasing in the next few quarters, fostering an uptrend within Canadian exports. However, volatility will persist, and we will see continuing ups and downs in the coming quarters.

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