January 8, 2019

Canadian Trade May Weaken Further Before Sunlight Appears

Canada, International Merchandise Trade balance (CAD billions), November:

Actual: -2.06

Scotia: -2.3

Consensus: -2.15

Prior: -0.85 (revised from -1.17)

- Life was grand for Canadian exporters back in Q2 but then a combination of unwinding an unsustainable pace of gains along with sundry distortions took down Canada's trade performance over H2 and it's not over yet. The window on trade conditions will get cloudier yet as the US government shutdown potentially affects the next release for December and Alberta's production cuts take down energy exports in January. Overall, it will remain very difficult to ascertain what is happening to the trade ledger for some time yet. That informs expectations for the BoC to pause its rate hikes over Q1 before possibly returning with renewed tightening thereafter.
- For now, the data is soft. The trade deficit widened broadly in line with expectations, but the positive revisions are worth nothing on a narrower than initially reported trade deficit in October. Export volumes fell by 1.8% and import volumes were down 0.3% m/m in November. While falling commodity prices and CAD depreciation played a role in distorting the value of exports and imports, the soft volumes are disconcerting. The updated charts below that incorporate revised data graphically depict the earlier sharp increases in volumes and the reversals since then.
- **There was considerable breadth to the weakness in export volumes as 8 out of 11 sectors were lower in November**. Some of the weakness is no doubt traceable to transitory bottleneck issues in the energy sector that were getting settled into late year and 2019 through rail and then the line 3 pipeline by Nov 2019. **Seven of 11 import volume categories were also lower.**
- **Canada's trade account continues to pay the price for a torrid pace of growth in Q2.** Export volumes were up a revised 20.6% q/q SAAR in Q2 over Q1 before then falling by 1.1% in Q3 and 5.4% in Q4. On the import side, volumes were up 6% in Q2, down 8.5% in Q3 and flat (+0.5%) so far in Q4.
- **I would argue that one should look through both sides of the trade ledger over 2018H2 and into early 2019 or at least treat the numbers with great care.** Front-loaded growth may have been a restocking effort by businesses ahead of supercharged US growth over Q2 and Q3. When combined with various disruptions including the Syncrude fire and transportation bottlenecks and then January's mandated oil production cuts by Alberta, the result is difficulty tracking underlying momentum absent such swings.
- **One issue I'd like to hear the BoC address tomorrow** is the extent to which they feel the recent data is due to some combination of a) pulled forward export demand (ie: the Q2 argument above), b) a more disturbing degree of retribution for lost export competitiveness, c) transitory distortions, or d) investment shortfalls that are driven by some combination of earlier NAFTA

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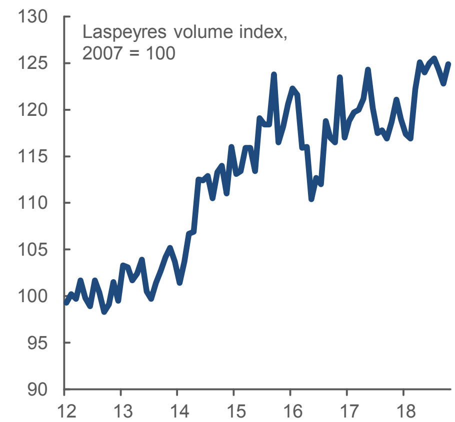
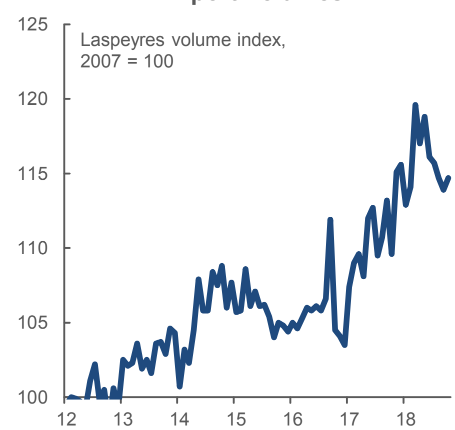
Export Volumes



Sources: Scotiabank Economics, Statistics Canada.

Import Volumes



Sources: Scotiabank Economics, Statistics Canada.

concerns plus relative competitiveness plus lost opportunity by Canadian businesses all of which could limit their ability to grow exports. **My hunch is that it's a combination of all of these arguments but that into 2019, positives could emerge** as distance from (a) and (c) grows and if businesses rise to the opportunity by capitalizing upon accelerated investment write-offs recently introduced by the Federal government. Our ongoing house assumption is no US recession over our 2019–2020 forecast horizon.