

Canadian Exports Play To Q2 Rebound, Q3 Stumble?

- Exports ripped higher in May and are pushing strongly higher in Q2...
- ...which drove the trade balance back into surplus...
- ...as trade is benefiting Q2 GDP growth...
- ...but idiosyncratic drivers dent at least some of the quality...
- ...while the export rise is much more than just a rebound effect...
- ...which raises why there was such strong country and industry breadth...
- ...amid plausible explanations for the gains being temporary

Merchandise trade balance, May, SA C\$ billions:

Actual: 0.76

Consensus: -1.7

Scotia: -2.0

Prior: -0.97 (revised from -1.08)

- Caution is always appropriate when interpreting the first swing at the piñata when it comes to Canadian trade figures. You could take strong figures at face value as the currency and short-term bond yields did through CAD appreciation and a small rise in the two year GoC yield on the back of these figures. But triggering elevated caution may be the wiser approach here. What is going up, up and way up in Q2 could very well result in renewed disappointment to export growth in Q3 and the report is replete with transitory idiosyncratic factors that dent the quality of the readings. For now, it's more rebound evidence in terms of Q2 GDP growth, but don't be so sure that the BoC will be enamoured of the export figures if they portend renewed weakening over H2 in such fashion as to leave intact serial disappointment of the export growth story. In any event, given these are figures for May and global trade uncertainties have since escalated, one might be inclined to view the figures as at least somewhat stale.
- What drove the totally unexpected surge in exports was likely a combination of transitory and idiosyncratic factors across multiple sectors as follows.
 - Autos:** StatsCan guided that "The increased production was partly due to the resumption of activities at some assembly plants following atypical shutdowns in April." This will fade as a growth driver.
 - Planes:** There was a 40.2% m/m rise in plane exports to US. This lumpy effect on the data will also fade.
 - Other transportation:** "Exports of boats and other transportation equipment almost quadrupled as a result of higher exports of other transportation equipment to Saudi Arabia." I'm guessing Canada didn't sell a whole lot of boats to the Saudis in May. Call it a hunch. More likely may be armoured cars given the prior contracts.
 - Energy:** Exports of refined petroleum products were up 20.4% m/m "mainly due to higher exports of heavy fuel oil the US." This may reflect the impact of Alberta's unwinding production cuts. If so, then fade this too.

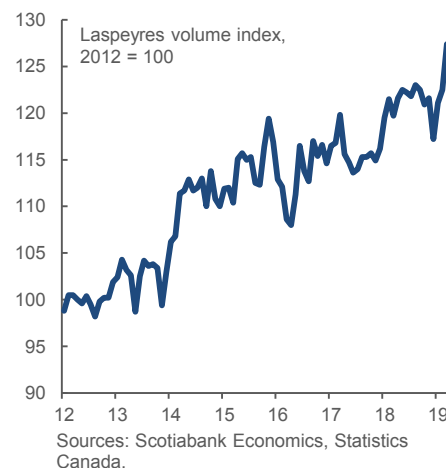
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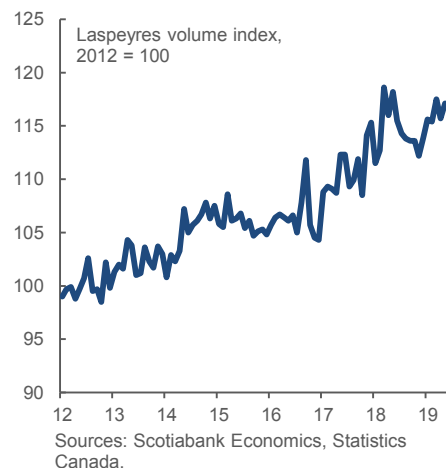
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Export Volumes



Import Volumes



- **Beyond idiosyncratic factors is the question concerning why such export strength occurred and where it went.** On that, these numbers are so strong that I can't help but be cautious toward them not just because we know that sectors like energy are inferred due to incomplete surveys in the first round prior to potential revisions. An over 20% annualized q/q export volume gain is being tracked for Q2. That far exceeds anything that could be reasonably expected to be just a rebound from Q1 softness and forces one to look elsewhere for the explanation. First, let's look at breadth by industry and country for the evidence.
- **Eight of twelve sectors are tracking double digit annualized export volume gains in Q2 which indicates high breadth.** Farming/fishing/forestry export volumes soared by 57% q/q SAAR. Metal ores exports are up 39%. Chemicals up 30%. Metal products up 12%. Autos up 24%. Broader transportation (autos, planes, trains, boats, atvs etc) up 107%. And of course, energy was up +16%.
- **By country, exports were up double digits m/m to five countries and up about 4% to the US as the dominant driver.** Exports to Japan were up 17.4% m/m, Germany 20.6%, South Korea 38%, Netherlands 31%, Italy 28%, all in month-ago SA terms. And of course, the US was up about 4% m/m. **Thus, even on a country basis there was strong breadth, but obviously skewed in weight terms to the significance of the US relationship.**
- Why was there such great breadth in the figures by industry and country? I'm not satisfied with simply assuming that the gains were legit or durable. For one thing, from the standpoint of the pull effect on Canadian exports, did these other economies all boom in Q2? **Did the world economy soar in Q2 against every other headline you've been reading for months now? Hardly.**
- **We're left searching for other plausible explanations and on that I'm afraid only theories and caution can be offered.** Is this just a combination of transitory effects, and/or trade diversion from China, and/or advance ordering ahead of rising trade concerns such as CUSMA implementation concerns and escalating China worries and straight into inventories abroad? All of these are plausible explanations, including the latter one given that the US manufacturing inventory to shipments ratio has been on the rise since October. I'm not sure, but this is one of the more unique trade reports I've seen in a while in terms of believability and the durability of the gains. Whether it's partly a rebound from Q1 or partly advance stockpiling on trade concerns or idiosyncratic factors or plain old unwise inventory management all leads to the same conclusion: the gains appear to be strong and supportive of growth in Q2 but there are very legitimate reasons to fade the gains.
- What does the report say to the BoC? In all frankness, they've been burned so many times by false starts in the export picture that it's probably sensible for them to be more cautious toward the recency of the gains shown in the two accompanying charts. But from a position of net slack in the economy at the end of Q1, the Q2 rebound probably closed some of the negative output gap. If that Q2 rebound is on shaky footings and gives way to renewed softening in Q3 such that actual GDP growth falls shy of potential growth once gain, then the output gap's narrowing in Q2 could be subject to renewed widening thereafter. That, in turn, would still leave the economy with net slack into the close of 2019 and likely well beyond. Who's talking rate cuts? Why the Fed, of course, notwithstanding the excess aggregate demand position of the US economy....

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