Canadian Trade: Do Imports Signal Weak Q3 Domestic Economy?

- A surprising trade surplus in June…
- ...masked disturbing underlying details
- Q2 got a trade lift from exports…
- ...while Q3 is so far tracking weak import signals of domestic activity
- The BoC's bias could depend upon how trade informs rebound durability

Merchandise trade balance, June, SA C$ billions:
Actual: 0.14
Consensus: -0.30
Scotia: -0.3
Prior: 0.56 (revised from 0.76)

Canada posted a surprising monthly trade surplus that masked a more disturbing underlying reality. What matters is that export volumes fell and import volumes fell by even more. That's a negative one-two punch that showcases weak exports and a soft domestic economy unable to pull in faster import growth as the economy transitions from the Q2 rebound into Q3 uncertainties. Overall, net trade will perversely contribute to GDP growth in June because of a lower import leakage effect. Indirectly, however, the issue is how widespread import weakness gets reflected in future activity readings on the health of the domestic economy during June.

The C$ depreciated slightly to the USD post-release but probably as much due to the US nonfarm payrolls release and volatile trade headlines. The Canada two year yield fell slightly.

In value terms, exports fell by 5.1% m/m and imports fell by 4.3%. Because exports started off bigger than imports, the relative percentage declines still yielded a trade surplus albeit a smaller one.

In volume terms, imports fell by 3.6% and exports fell by 1.5%. Price effects played a large role in this report but the main emphasis should be upon the weakened volumes.

The breadth of the decline in imports was widespread. Nine of eleven sectors fell in value terms. In volume terms, eleven of thirteen sectors fell. Imports of machinery and equipment fell by 5.2% as a very negative signal on how business investment is starting off tracking in Q3 given most capital goods tend to get imported by Canadian businesses. There were sizeable declines in every import volume category with the only exceptions being increases for metal products and 'special transactions' that capture low-valued transactions, equipment repairs and returned goods.

The breadth of the decline in exports was also disturbing. In value terms, 10 of 11 categories fell. In volume terms, of 10 of 13 sectors saw declines. The only bright spots in volume terms were the farming/fishing/forestry category and energy as exports of machinery and equipment were flat.

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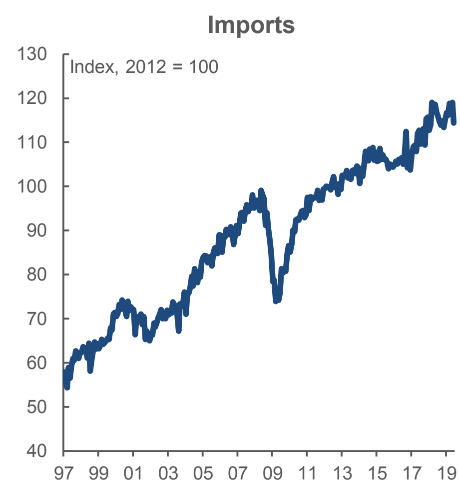
Sources: Scotiabank Economics.



Sources: Scotiabank Economics.

For Q2 overall, export volumes were smoking while import volumes fell a little. The hand-off math to Q3 bakes in flat export volumes and a significant decline in import volumes such that net trade is so far tracking positively as a Q3 GDP driver at least directly, and not for great reasons. The import volume weakness baked into Q3 is, however, an early warning signal about the durability of the domestic drivers of growth.

At the margin, it's game on for tracking the durability of the rebound in Q2 and whether it fades over H2. That's what matters to the Bank of Canada that our house view doesn't expect to ease, but if domestic data rolls and external risks (e.g. trade policy, commodities, Brexit etc) evolve unfavourably then the BoC bias into Fall will require close monitoring.