Canada Q2 BoP: Fade the Trade 'Miracle'

- **Canada's current account deficit narrowed to CAD 6.4 bn in the second quarter, its smallest shortfall since 2008, owing almost entirely to the reduction of the deficit in goods trade.**
- **The narrowing of the trade in goods deficit was driven, however, largely by transitory effects from reduced oil production curtailments, the return of auto plants to production following maintenance shutdowns, and dips in imports of aircraft and other transportation equipment and parts.**
- **Foreign direct investment (FDI) into Canada rebounded with inflows of CAD 21.7 bn in Q2, up from CAD 12.1 bn in Q1.**

NARROWEST CURRENT ACCOUNT DEFICIT SINCE 2008

Canada's current account deficit narrowed to its smallest level since 2008, declining from CAD 10.2 bn in Q1 to CAD 6.4 bn in the second quarter of 2019. The shrinkage in the deficit for trade in goods was the primary driver in the overall reduction in the current account deficit (chart 1). This was wholly in line expectations as there were no material revisions to the monthly international merchandise trade numbers reported earlier this month.

The deficit in goods trade narrowed from CAD 8.9 bn in the first quarter to CAD 0.3 bn in the second quarter largely because of temporary developments. Exports of goods increased by CAD 7.6 bn compared to Q1, led by energy products, up CAD 3.4 bn on Q1, owing to the easing of production curtailments in western Canada coupled with higher prices. Motor vehicles and parts export volumes also increased as certain auto plants came back online following maintenance closures. Lower imports also contributed to narrowing the overall trade deficit, with a reduction of CAD 1.0 bn in imports versus Q1, which was attributed mainly to a large decrease in imports of aircraft and other transportation equipment and parts (down CAD 1.9 bn compared to Q1). **These transitory positive drivers are unlikely to continue into Q3 as global demand is flagging and trade tensions have increased.**

The services trade deficit also narrowed slightly, coming down by CAD 0.7 bn compared with the Q1 deficit of CAD 5.2 bn. Exports increased by CAD 0.4 bn, driven by travel services and technical, trade-related and other business services, while imports decreased in all three broad categories, with transportation services (down CAD 0.2 bn from the previous quarter) leading the way.

Total net investment income flows posted a CAD 2.4 bn gain over the previous quarter to move into a surplus of CAD 0.5 bn—the first time that Canada has ever been in the black on this current account component. Net profits on direct investment were the main driver behind the surplus, with an increase of CAD 1.4 bn over Q1 to hit net CAD 7.0 bn in Q2. This continues a streak of positive net profit flows on direct investments going back to Q4 2014.

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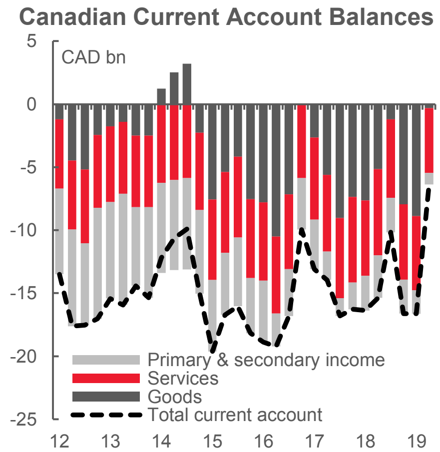
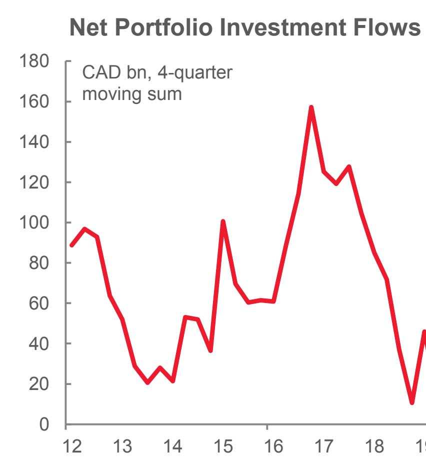
Chart 1



Sources: Scotiabank Economics, Statistics Canada.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

CAPITAL ACCOUNT NET OUTFLOWS

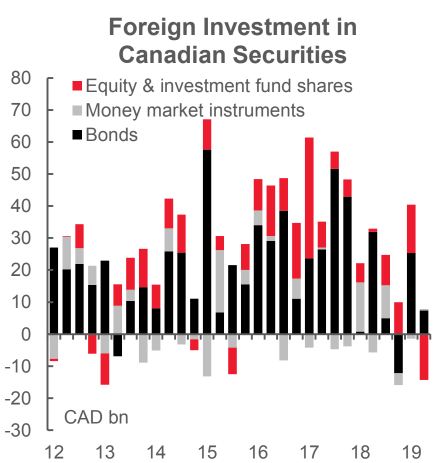
Total portfolio flows showed a net outflow of CAD 17.0 bn from the Canadian economy in Q2. Net portfolio flows into Canada have been on a downward trend since Q4 2016 (chart 2).

- **Foreign investors reduced their holdings of Canadian securities, for the second time in three quarters, by CAD 6.5 bn in Q2.** Non-resident investors purchased CAD 7.8 bn in Canadian debt securities, but divested themselves of CAD 14.3 bn in Canadian equities, the first divesture in almost 4 years and the largest since the fourth quarter in 2007 (chart 3).

- **Canadian investors increased their foreign portfolio holdings by a net CAD 10.6 bn.** The majority of the funds were allocated to foreign debt securities (chart 4).

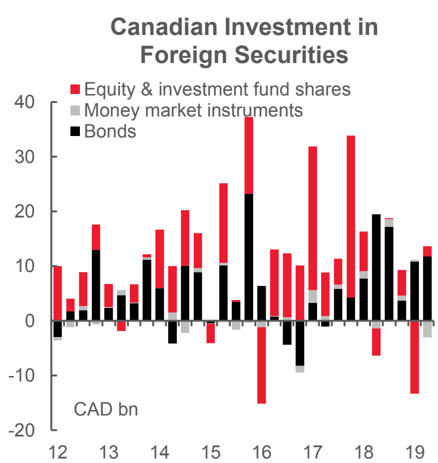
Canada received CAD 21.7 bn in direct investment in Q2, the largest inflow of direct investment funds since Q3 2015. Meanwhile, Canadians invested CAD 25.9 bn abroad—resulting in a net direct investment outflow of CAD 8.3 bn on a 4-quarter moving sum basis (chart 5). The majority of investment into Canada was focused on the energy and mining sector while Canadian investment abroad was focused in the US and financial sector generally.

Chart 3



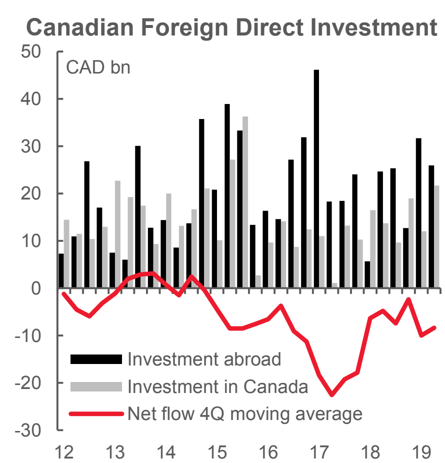
Sources: Scotiabank Economics, Statistics Canada.

Chart 4



Sources: Scotiabank Economics, Statistics Canada.

Chart 5



Sources: Scotiabank Economics, Statistics Canada.