Canadian Exports Are Succumbing To Renewed Weakness

- Canada trade deficit worsened
- Export and import volumes fell
- Export volumes have reversed the summertime respite
- Export and import breadth was soft…
- ….with only 3 of 11 export sectors posting volume gains
- Exports volumes are tracking as a drag on H2 GDP growth
- BoC would be unlikely to tolerate CAD strength…
- …as trade deteriorates
- Revisions remain a risk on incomplete surveys

Merchandise trade balance, Sept, SA C$ billions:
Actual: -0.98
Consensus: -0.65
Scotia: -0.60
Prior: -1.24 (revised from -0.96)

Canada's latest batch of trade figures is weak all around. Not only was the monthly deficit wider than expected against the consensus guess for an improvement, but the underlying details were generally worse. It was premature of the BoC to guide that the rotation of the sources of growth toward exports has already happened. Indeed, the deterioration amidst global softness and weak domestic oil prices makes it unlikely the BoC would tolerate CAD appreciation.

Export volumes fell by 2.1% m/m in September and import volumes fell by 1.6%. The volume level of exports fell back to where it was in March which wipes out the summertime gains. See charts 1 and 2 for volume trends.

That makes for pretty awful math for Q3 and by way of the hand-off effect to Q4.

Q3 export volumes in Canada fell by 2% q/q SAAR and import volumes were up by 6.4% q/q SAAR. That drove a sharp deterioration in the overall quarterly trade balance.

Because of the way the math works via the ending point to Q3 and the Q3 average, there is a baked in 6.8% q/q SAAR drop in export volumes being tracked for Q4 and a 2.3% drop in import volumes q/q SAAR. The usual caution that applies is that we don't know any data for Q4 yet and there may be revisions in future.

So what this means is that the Q2 surge was the only flash of optimism for Canadian trade and it was built on transitory foundations. Export volumes were up 14.8% in Q2 q/q SAAR and import volumes were flat in Q2 (-0.6%) before the Q3/ Q4 turn.

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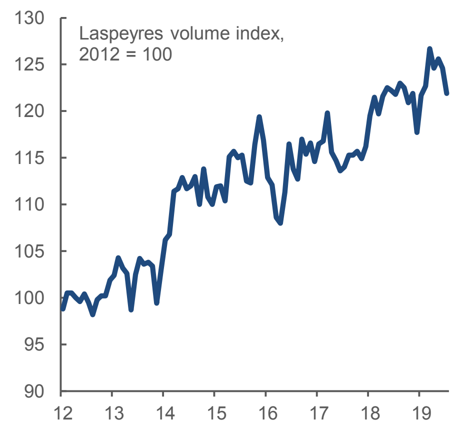
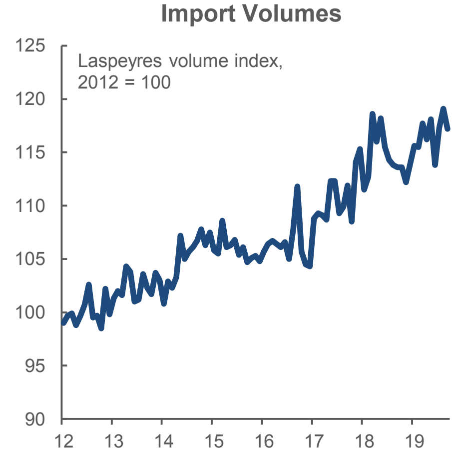
Export Volumes



Sources: Scotiabank Economics, Statistics Canada.

Import Volumes



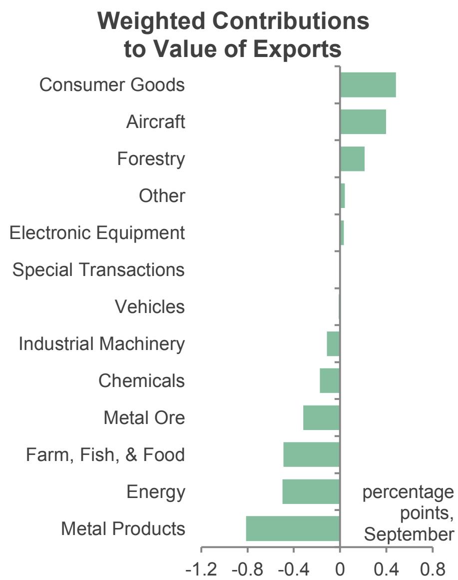
Sources: Scotiabank Economics, Statistics Canada.

On the export side, exports were down in 7 of 11 sectors both in value (chart 3) and volume (chart 4) terms. Energy export volumes fell again due to seemingly never-ending maintenance issues at Canadian energy projects. Nevertheless, there was fairly widespread weakness in export volumes with seven sectors down, three others little changed and only three upsides.

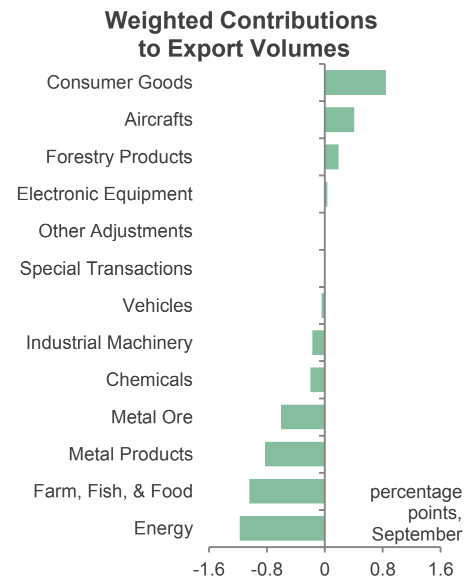
On the import side, there were distortions, but breadth was still soft. 7 of 11 sectors were down in value terms (chart 5) and also 7 out of 11 import volume categories fell (chart 6). Gold imports fell sharply to drive metal and non-metallic imports lower as the weakest area, but the overall import side of the ledger was soft.

From the standpoint of our BoC expectations, when trade is suffering yet another setback at a fragile time in the outlook, it's unlikely that the BoC would welcome the appreciation in CAD since the start of the year from USDCAD 1.3640 to a nickel stronger now. Some of this has definitely been driven by relative central bank policies as the C$ appreciated in part while the Fed moved to cutting while the BoC held steady. Holding the policy rate steady while the Fed cut has the BoC tightening conditions for exporters at an inopportune moment. This is one reason we've been leaning toward BoC rate cut arguments since June.

Nevertheless there are—and have to be—other drivers of the BoC forecast than just the C$, but it's among the factors. The main over-arching point is the output gap and inflation framework as Canada will have only surpassed potential growth once (Q2) in the 5 quarters up to year-end if the BoC's 1.3% growth in Q3 and Q4 comes true. There is modest slack in Canada and there would be no progress toward closing with numbers like that. Thus, the BoC could become increasingly concerned about the durability of its 2% inflation target. I also believe it remain inappropriate justify the policy rate on the basis of finally hitting the mid-point of the inflation target range after having missed it 90% of the time using monthly year-ago percentage changes since 2012 and in the context of soft measures of business and market-based inflation expectations.



Sources: Scotiabank Economics, Statistics Canada.



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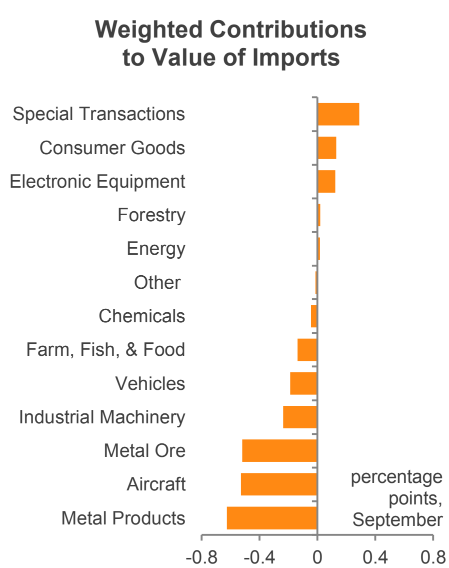

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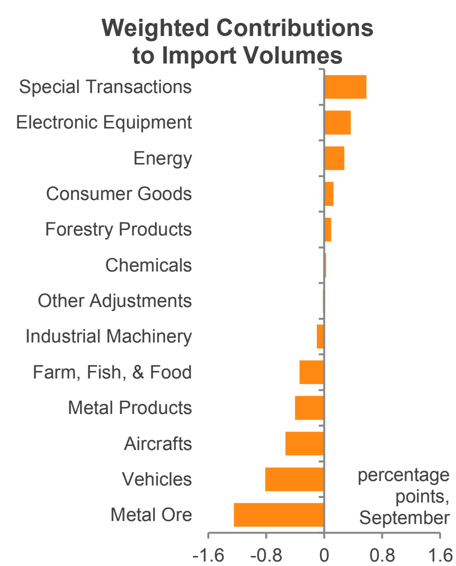

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