CONQUERING THE CHASM

Global Export Forecast
Spring 2015 – Summary

Canada

EDC
Realize a World of Opportunity

The audience gasps. Way up in the vaulted canopy, the high-wire act falters. They've seen this all before, numerous times. At first, they couldn't look – the odds of a horrible end seemed too great. But time and again, the foothold was regained, and the act resumed. Now, it looks like that master wire-walker is actually going to make it, and with rapt attention, the throng is willing that lone figure to succeed. Will the world economy's high-wire act really end well?

The setbacks have been manifold. Most recently, neo-stagnation has been the worry. From Europe's brush with "triple-dip" to Japan's new-tax trauma to the demand difficulties of the emerging market giants, steady growth has been elusive. Trouble is, steady economic movement is essential to coping with and overcoming the structural weaknesses revealed and magnified by the crisis of 2008-09. So far, so good: we have not been knocked off our game by impossible fiscal chasms, financial market carnage, waves of political upheaval, experimental policy measures and a host of smaller but significant inhibitors. Consistent movement is about all that remains to get global commerce to the end of the high wire and on to a firmer footing.

Canada has had a firmer foothold than most, but lately there have been clear signs of fatigue. Consumer debt levels have soared. Housing markets are overbuilt. Governments at the provincial level still face years of austerity. Plunging prices are decimating the resource industries, which have been until recently an economic mainstay. Consequently, domestic investment is slowing. High-profile retailers are pulling up the tent pegs, while others are consolidating. Suddenly, our own high-wire act is looking precarious. Will we make it?

Thankfully, there's a wire-walker that is a standout. It certainly didn't start well for this one; it began as the weakest of the bunch. But it is now moving surely, and is practically running across the wire. And it just happens to be Canada's number one customer. America is going full-tilt, and thankfully, its success is catching on. Can its momentum carry it – and the rest of us – along, or like the rest of the world, is it also at great risk of a bad turn of events? The difference for the US economy is the presence of an essential ingredient – pent-up demand.

It is probably most obvious in the US housing market. Dramatic growth notwithstanding, US housing market activity still finds itself well shy of the basic demographic requirements of the economy. That was necessary a few years ago to get rid of the egregious excesses that had swamped the market. But those are now long gone, and it is becoming more obvious that the market is in deficit. In fact, it can easily grow by 40% over the next year or two and only just be meeting the current needs of the market. More growth is needed to deal decisively with the deficit.

What's even more inspiring about this sub-market's about-face is that it is a key leading indicator of economic activity. Its movements are replicated in other economic developments months down the road. As such, if strong, double-digit growth can be expected here, it is likely to show up elsewhere in short order. One of the first places is consumer spending. Imagine all the fixings that are needed for the wave of newly built homes in the marketplace. This demand in turn creates jobs and incomes that pull more players into the spending game. Not to mention that Americans are driving around in clunkers that need a serious near-term upgrade.

Get the US consumer going, and it's a major accomplishment. They account for almost 70% of the world's largest economy. Their absence over the past 7 years has been felt by the broader economy. Their return is having huge repercussions, not just for the US economy itself, but for the world. Simple math shows that American consumers account for 13 cents of every dollar that circulates worldwide. This revival is for everyone.

Is that the end of the story? Far from it. Believe it or not, there is even more excitement in the business investment arena. Groggy from a protracted hibernation, US business is waking up to a crisis of a different sort. The fast ramp-up of activity has gobbled up existing resources so quickly that there's a widespread capacity crunch. Capital spending has vaulted up into the double digits, and given the pace of new orders, more new capacity is definitely needed in the near term. In fact, there's a worry that the capacity to create new capacity is also tight, suggesting risk that orders may not be met. Add it all up, and we are expecting US GDP growth of 3.6% this year, and 3.3% in 2016. Does low capacity put this outlook at risk?

Ironic that we have been so worried about a lack of demand, and now it's a lack of supply that may ruin the recovery. Is it, indeed, a real threat to global growth? Quite the contrary, it's likely a guarantee of growth. Global crisis spurred a dangerous reversion to protectionism – Buy American, France First and so on. Sadly, some of the greatest beneficiaries of globalization were the first to jump on the protectionism bandwagon. Re-shoring became a popular buzz-word. The outcome? For starters, apart from very near neighbours, US growth has thus far been fairly self-contained. But bumping up against capacity limits changes the picture. Assuming firms will not turn business away, capacity is now more likely to be sourced from abroad – finally spreading the benefits of US growth further afield. Additional encouragement will come from the fast-appreciating greenback, up by over 12% on a trade-weighted basis since mid-2014. Do the numbers agree?

It's too early to tell, but so far, results are encouraging. The Eurozone has definitely shrugged off the worst fears of a triple-dip, and recent data on both expectations and real activity are quite positive. There will need to be much more evidence before we can conclude that Europe is on a new, higher-growth trajectory, but our expectations, which are much the same as others', is that growth will accelerate to 1.6% by 2016.

Europe is on the move. Most of the news on China is bleak. Soft domestic demand, punctuated with stories of policy-led construction excesses and financial market fragility, is the predominant theme, leading many forecasters to write down growth to something just under 7%. Absent a significant change in external growth, this is reasonable. However, considering the international trade vacuum that opened up in China back in 2009 and the lack of OECD-area growth since, a return to developed-market growth – starting with the US economy – suggests something much better for China's exports in the near term. If our outlook for the US and the Eurozone is realized, it is entirely possible to see China's export growth back up into double digits, enough to see trade climb back into the economy's driver's seat.

Plunging oil prices are adding more than a casual wrinkle to the outlook. Resource-sector investment has been a vibrant island of growth in an otherwise weak world. Now that picture is changing, and there are big questions about the net effects. These are covered in a special article on the issue. On balance, we believe that the positive effects on net oil-consuming economies will outweigh the negative effects on the big oil producers, lifting global growth. The price shakeout is itself related to the return of growth and the unwind of extraordinary post-crisis monetary

measures. Prices for a range of commodities were artificially high, and are now trying to find a more stable platform. Until that point, we can expect turbulence.

World growth will benefit from the robust US performance and its knock-on effects on the rest of the world. Our forecast calls for growth this year of 3.5%, and for an additional 3.9% in 2016. We're getting to the end of the tightrope.

Plunging resource prices are taking a bite out of Canadian GDP growth this year. The impact on the energy sector is dramatic. However, lower resource prices have also brought the Canadian dollar down with them. The non-energy manufacturing sector, already benefiting from the rise in US demand and tightening American capacity, now has a currency bonus enhancing price competitiveness. The result is upheaval on multiple fronts. Growth is shifting from the domestic sector to external demand, and even on the external side, growth is shifting dramatically from the resource side to non-resource manufacturing and services. Given our expectation that oil prices will average just over USD60 per barrel this year, the net effect on GDP growth is about 0.3%. As such, Canada's growth is expected to average 2.4% this year and next year..

Canadian exports did well in 2014. Merchandise exports grew by 10.9%, aided by favourable prices, but over half of the growth was sheer volume activity. Momentum is strong going into 2015, and based on the shifts in the economy, the outlook for overall trade is positive. The crying need for capacity stateside is expected to power double-digit growth in non-mining equipment exports. The auto sector will also see two-digit performance, thanks largely to the weaker dollar. Aerospace will capitalize on a strong showing in other aircraft and parts exports and the slumping value of the Canadian dollar. Consumer goods will also do well, thanks to Americans opening up their wallets once again.

Energy exports are the big spoiler. Volume shipments are actually forecast to rise modestly, but prices will drive total sales down by 23.3%. A partial recovery is forecast for 2016, split roughly between volume gains and a partial recovery in prices.

The bottom line? The global economy has very skillfully traversed its largest chasm in recent memory. It has been a death-defying high-wire act, with safety nets that long since became very frayed. The wire-walker is perhaps weary, but gaining courage from the success of efforts past and the obstacles overcome. While still vulnerable to any disturbance, the current proximity to the "other side" is building confidence that we are making it. Our challenge? To ensure that we shift along with the balance of growth, capturing as much of it as we can.

Table 1: Key Economic Estimates (KEEs)

EXPORT FORECAST OVERVIEW	2012	2013	2014	2015 (f)	2016 (f)
GDP (% y/y)					
Canada	1.7	2.0	2.4	2.4	2.4
United States	2.3	2.2	2.4	3.6	3.3
Euro Area	-0.7	-0.5	0.8	1.4	1.6
Japan	1.5	1.6	0.1	1.1	1.2
Developed Markets	**1.2**	**1.3**	**1.8**	**2.5**	**2.5**
Emerging Asia	6.7	6.6	6.5	6.8	6.9
Latin America and the Caribbean	2.9	2.8	1.2	1.2	2.4
Emerging Europe	7.4	4.7	2.7	-1.3	0.8
Africa and Middle East	5.0	3.1	3.3	4.1	4.8
Emerging Markets	**5.1**	**4.7**	**4.4**	**4.3**	**4.9**
World Total	**3.4**	**3.3**	**3.3**	**3.5**	**3.9**
Currencies					
USD/CAD	1.00	0.97	0.91	0.82	0.84
Commodity Prices					
WTI	$94	$98	$93	$61	$71
Lumber (WSPF, US$ per thbf)	$255	$318	$349	$383	$400
Copper (USD/MT,LME)	$7,947	$7,322	$6,862	$5,806	$5,995
Wheat: Canada (USD/Metric Ton)	$7	$7	$6	$5	$6
Other					
US housing starts ('000s)	780.60	924.90	1,005.80	1,350.00	1,550.00

Sources: Statistics Canada, EDC Economics

Table 2: Canadian Merchandise Export Forecast by Region

EXPORT FORECAST OVERVIEW	CAD bn 2014	% Share of Total 2014	Export Outlook (% growth) 2014	2015 (f)	2016 (f)
Developed Markets					
United States	375.9	76.5	12.2	-1	9
Western Europe	39.2	8.0	15.5	2	6
Japan, Oceania and Developed Asia	23.4	4.8	2.9	1	-2
Emerging Markets					
Latin America and the Caribbean	13.3	2.7	7.3	4	5
Emerging Europe and Central Asia	3.5	0.7	-5.3	-6	3
Africa and the Middle East	8.4	1.7	17.8	7	7
Emerging Asia	27.8	5.7	-2.1	4	5
Total Goods Exports	**491.6**	**100.0**	**10.9**	**0**	**8**
Total Emerging Markets	**53.1**	**10.8**	**2.7**	**4**	**5**
Total Developed Markets	**438.5**	**89.2**	**11.9**	**-1**	**8**

Sources: Statistics Canada, EDC Economics

Peter G. Hall
Vice-President and Chief Economist

Canadian exports of goods and services are projected to see low growth of only 1% in 2015 due in large part to plunging oil prices. This will overshadow double-digit export growth for 6 out of 12 export categories and a strong underlying expansion in volumes, especially from the US. The following year, continued strong external demand and rebounding energy prices are forecast to lead exports to a 7% expansion.

The fall in oil and natural gas prices will combine to subtract CAD 53 billion from energy exports this year. Although crude oil shipments are actually set to increase, this will not outweigh the effect of the forecasted 35% drop in the price of oil this year. Canadian energy exports will shrink by 23% in 2015 before rising by 23% in 2016 as prices stage a partial recovery and crude volumes expand further.

All manufacturers stand to gain from the lower value of the Canadian dollar and healthy external demand. Aerospace exports will increase by 17% this year and 19% in 2016, which is supported by the slumping value of the Canadian dollar. Automotive exports will also benefit from the slumping loonie in 2015, but with the industry running at capacity, growth will shift down to 1% next year. Improved external competitiveness and a revitalized US consumer translate into positive longer-term prospects.

For commodities other than oil and natural gas, the outlook is mixed. Fertilizers will see growth of 17% in 2015, as prices increase. Meanwhile, lower iron ore prices and output will limit growth for metals and ores to a mere 5% in 2015 and 3% in 2016. Canada's agri-food exports will rise by 8% in 2015, driven by a boost from the lower value of the Canadian dollar and moderate export volume growth amid sustained world food demand. In 2016, the sector will see export receipts rise by just 1% as yields normalize.

Table 3: Canadian Merchandise Export Forecast by Sector

EXPORT FORECAST OVERVIEW	CAD bn 2014	% Share of Total Exports 2014	Export Outlook (% growth) 2014	2015 (f)	2016 (f)
Agri-Food	56.3	9.6	12.1	8	1
Energy	142.0	24.2	14.7	-23	23
Forestry	32.5	5.5	9.2	7	3
Chemical and Plastics	41.6	7.1	12.5	4	4
Fertilizers	6.9	1.2	-11.4	17	6
Metals, Ores and Other Industrial Products	72.8	12.4	7.5	5	3
Industrial Machinery and Equipment	30.6	5.2	9.5	14	5
Aircraft and Parts	14.5	2.5	28.6	17	19
Advanced Technology	14.6	2.5	5.5	17	2
Motor Vehicles and Parts	67.9	11.6	8.7	13	1
Consumer Goods	7.7	1.3	-3.8	12	5
Special Transactions*	4.2	0.7	16.6	7	4
Total Goods Sector	**491.6**	**83.8**	**10.9**	**0**	**8**
Total Services Sector	**95.2**	**16.2**	**2.9**	**5**	**4**
Total Exports	**586.8**	**100.0**	**9.5**	**1**	**7**
Memorandum					
Total Volumes			**5.3**	**4**	**4**
Total Goods Nominal (excl. Energy)	**349.6**	**59.6**	**9.4**	**9**	**3**
Total Goods Nominal (excl. Autos and Energy)	**281.7**	**48.0**	**9.5**	**8**	**4**

Sources: Statistics Canada, EDC Economics, 2014 is actual data while 2015 and 2016 are forecast.

Special transactions* mainly low-valued transactions, value of repairs to equipment and goods returned to country of origin.

Crashing energy prices will overshadow strong external demand this year, keeping merchandise exports flat in 2015. This is in stark contrast to non-energy exports, which are expected to see relatively broad-based gains in all provinces. Next year, overall growth will resume at a brisk 8%, driven by sustained US and global demand along with a partial recovery in energy prices.

In 2015, **Alberta** will be the hardest hit of all provinces as exports plunge 17%. The volatility will continue next year, but in the right direction, as rising prices and oil volumes see exports record a solid rebound. The story is much the same for **Newfoundland and Labrador** as exports fall 14% this year before recovering oil and metals prices prompt a solid double-digit expansion in 2016. Reflecting their sensitivity to energy prices, a similar growth pattern is expected for both **New Brunswick** and **Saskatchewan**. All this said, peeling away the impact of energy reveals a much more optimistic story for each of these provinces in 2015.

Headline figures are markedly different for the manufacturing heartland where a weaker Canadian dollar and resurgent US demand are the key drivers. **Ontario** will lead all provinces in 2015 as exports advance 10%. Growth will gear back to 2% in 2016 as automotive capacity constraints take hold and the impact of the Canadian dollar on export prices wane. Solid and steady is the best way to describe the outlook for **Quebec** as that province turns in the best two-year average growth rate of all provinces at 7%. The manufacturing sector in highly diversified **Manitoba** will also allow that province to elude negative export growth in 2015, despite a forecast 20% decline in its energy exports.

For **British Columbia**, lower natural gas prices are more than offset by gains in sectors like agri-food, ores, machinery and equipment, and forestry. Continued growth in these sectors and recovering natural gas prices will lift exports an additional 6% next year. In **Prince Edward Island**, the chemicals and aerospace sector will have a profound impact on provincial exports, pushing them to a 9% expansion in 2015. Finally, **Nova Scotia** will receive a lift from seafood, forestry and tires, boosting exports to 7% growth.

Table 4: Canadian Merchandise Export Forecast by Province

PROVINCES	CAD bn 2014	% Share of Province's Total Exports 2014	Export Outlook (% growth) 2014	2015 (f)	2016 (f)
Newfoundland and Labrador*	13.0	2.6	9.2	-14	19
Prince Edward Island	1.1	0.2	19.6	9	4
Nova Scotia	5.3	1.1	24.7	7	3
New Brunswick	13.0	2.6	-10.4	-10	11
Quebec	74.4	15.1	14.7	7	6
Ontario	177.3	36.1	8.0	10	2
Manitoba	13.4	2.7	6.5	2	3
Saskatchewan	35.1	7.1	8.9	-5	7
Alberta	121.4	24.7	17.9	-17	19
British Columbia	35.5	7.2	6.2	5	6
Territories	2.2	0.4	24.4	12	8
Total Goods Exports	**491.6**	**100.0**	**10.9**	**0**	**8**

Sources: Statistics Canada, EDC Economics, 2014 is actual data while 2015 and 2016 are forecast.

*Includes EDC estimate for crude oil exports (*not included in national total from Statistics Canada)

For the complete Spring 2015 Global Economic Forecast, visit

www.edc.ca/gef

EDC

Realize a World of Opportunity