
Exports Suffer as Global Demand Falters

Overview

The recession that hit Canadian exports last year will continue into 2009. World economic growth has continued to weaken, particularly among Canada's traditional trading partners. The global economy will manage to expand by just 1.1 per cent this year, after 3.4 per cent growth in 2008 and an average of 5 per cent in each of the two preceding years. Net of the volatile price movements that are occurring, Canadian exports are forecast to tumble this year by 5.1 per cent, following a 6 per cent drop in 2008.

More bad news ahead

Economic conditions deteriorated steadily in 2008, but the severity of the downturn was not fully appreciated before seismic shocks hit financial markets and world demand last fall. At that point it became clear that the slowdown had become a global recession, and that it was going to be a deep one. World growth has not been this weak since the very early 1980s, and the risk is that growth could actually be weaker still. The speed of this shift in the outlook, together with the shocking deterioration of the financial sector, has had a marked effect on confidence around the globe.

Pessimism would have a chance of ebbing if the bad news was over. Unfortunately, newsstands are in for successive waves of grim headlines. The slowdown that began with the US housing implosion infected global financial markets, which then became a US-consumer-led slowdown in global demand. The spillover effects on emerging markets – even the star performers – are yet to be fully reported, but the telltale signs of deceleration are manifold.

A further wave of weakness is the lagged impact of lower demand on labour markets. Unemployment in large industrialized markets is rising, but has only just begun. Compared with previous downturns, we still have a way to go before we turn the corner. Markets will not react favourably to monthly reports of job losses and the attendant impact of rising unemployment on demand conditions. What is more, the second-round impact of further consumer weakness on financial markets will be significant.

Nobody gets a bye in this round

Few will escape the impact of the global recession. Industrialized economies as a group are expected to contract by 1 per cent in 2009, an almost unthinkable situation just six months ago. The U.S. together with the U.K. and Japan will be among the weakest performers this year, bad news for Canadian exporters. Emerging markets will spend the year adjusting to a very new, if temporary, reality. After experiencing 7 to 8 per cent growth in the heyday years, collective growth is expected to weaken to just 3.8 per cent in 2009. While the pace of growth still appears robust, it is well below emerging market potential growth, and implies a rise in unemployment and lower capacity utilization rates. Each of the large BRIC-M emerging markets will see a significant slowdown, but the most dramatic recoil will be seen in Russia, which is now forecast to experience a mild contraction this year.

Public policy swings into action

Governments around the world have leapt into action. A concerted effort was made last fall by central banks and public treasury officials to deal with the toxic assets that posed a clear threat to some of the planet's largest financial institutions, and their considerable efforts are ongoing. In addition, monetary authorities have slashed interest rates to historic lows in an effort to partially offset the approaching economic weakness. Sensing the severity of conditions, governments – even the more conservative ones – have adopted a much more Keynesian approach to fiscal

policy. Collectively, Western governments have become far more willing to run temporary deficits, and substantial ones at that, in order to stimulate short-term growth. Further substantive spending announcements are expected to occur in the short term.

Don't bet on an early recovery

Will the economy begin to recover later this year? Not likely. The unusually long expansion that just came to an end created significant economic excesses in the past five years. These excesses were not isolated to particular economies; globalization has ensured that the excesses were exported around the world, and most economies will spend 2009 and part of 2010 working them off. As such, global activity is not forecast to pick up in a big way until the latter half of 2010.

Canada feels the pinch...

Canada's domestic economy was in a strong position heading into the economic downturn. However, we are still a trading nation, and the whole Canadian economy is now feeling the impact of weak global demand. One of the more spectacular impacts is the sharp drop in commodity prices. Primary producers rode the wave of rising prices for a number of years, but that came to a dramatic end in the latter half of 2008. Oil prices crested at US \$147 per barrel in early July, but are presently struggling to stay at US \$40 per barrel. The forecast calls for prices to stabilize at US \$55 per barrel in 2009. Base metal prices have also suffered a wild contraction, and are expected to remain muted through the downturn. Prices of forestry products are in for a further drubbing, as US housing markets fall further and as lower advertising activity reduces the page counts of newspapers and magazines. Agriculture prices have also succumbed to the global recession.

...but a weaker dollar will help

Canadian manufacturers can generally see a bright side to lower commodity prices. First, input costs are lower, reducing some of the stress on margins. Second, the Canadian dollar will remain well below recent peak levels, fluctuating in the US \$0.80-to-\$0.85 range over the next two years.

Even so, few industries will be able to dodge the global weakness. Significant commodity price declines will pummel the value of shipments in the energy, metals, plastics and chemicals industries in 2009. Exports will lose ground yet again in the beleaguered forestry industry. Auto sector production will see a significant decline given the contraction in US vehicle sales and financial constraints in the industry. Advanced technology exports will retreat as weaker corporate profits dent investment intentions in the short-term. Consumer goods shipments will follow the gloomy trend in US consumer spending, contracting by 5.6 per cent, the third successive annual drop for the sector. But declines will not hit all industries. Solid global demand for agrifood products and fertilizer will keep these important Canadian sectors growing. The aerospace sector is forecast to increase shipments as Canada's product mix is in high demand.

Opportunities

Times may be tough, but the global economy is not devoid of opportunities. Emerging markets will face challenges, but their longer-term prospects are still bright. Moreover, short-term growth will still outpace activity in our traditional markets, and as such, diversification of sales – even in difficult times – presents an opportunity to stabilize overall sales. There is further opportunity in the large public spending projects that are underway or impending in the short term. Shovel-ready projects are likely to begin as soon as possible – governments want infrastructure spending to occur right away so that they stimulate the economy in the middle of its soft spot. As such, contractors will look very favourably on those who are prepared to go into action quickly. Opportunities are likely highest in economies that have significant projects, but lack the domestic capacity to supply the wide range of goods and services required.

The bottom line

Near-term global economic prospects are grim, and they will push the Canadian economy into recession. Most industries will feel the effects of the global malaise. Circumstances are bad...but

not bottomless. Recovery ought to occur in the latter half of 2009, and in the mean time, those willing to venture into non-traditional markets will find lucrative short-term growth opportunities.