



THE RACE TO RECOVERY

GLOBAL EXPORT FORECAST
SUMMARY FALL 2009

THE RACE IS ON. And this is no ordinary race. Far from the standard contest to reveal an ultimate winner, this one is about endurance. Also, there wasn't much choice about this one – all were thrust into the contest. This race is also a more gruelling test of mettle than most have ever seen, and many have dropped out in mid-course. This is the race to economic recovery, and although it already seems drawn out, the finish line is still a long way off, far beyond the racers' current line of sight.

A race run before?

It sounds daunting. But haven't we been through economic cycles before? Is this one really so different from past recession-recovery episodes? In terms of the actual dynamics, the current recession is indeed no different from its predecessors. An expansion period culminated in excessive activity, and true to form, the bubble ultimately burst. As in previous episodes, we're in a waiting game for recovery.

Yet this one is different, in a number of respects. First, the present downturn is a lot larger than anything on memory. The expansion was about twice as long as normal, and as a result, the bubble was super-sized. The recession is likewise expected to be outsized, once the final numbers are in. A second feature of the current downturn is its global reach. The vast increase in globalization since the early 1990s ensured that this cycle's excesses were not localized – they were exported everywhere. Consumption excesses in the West became production excesses all over the world. Likewise, contraction ricocheted around the planet.

A third distinguishing feature is the shock factor. The past growth cycle was so long – about 16 years – that many businesses, labourers and policymakers alike have never lived through a recession. Experience is thin, and many are ill-prepared to weather current circumstances. Fourth, policy action sets this cycle apart from others. Measures taken by policymakers can easily be described as dramatic for their size, their global coordination, and in certain cases for their originality. To sum up, races like this have been run before, but the current course is new to everyone.

Key hurdles

We're well into this race. It was barely noticeable when it began back in early 2006. But it got a lot more attention when the hurdles appeared. The near-collapse of large Western financial institutions, first in the spring and then more seriously in the autumn of 2008, was a daunting obstacle. Creative, coordinated solutions staved off a collapse of confidence and systemic failure – the first hurdle was cleared, by a whisker.

The second came in rapid succession: a massive drop in output. From the final three months of 2008 to mid-2009, the world's largest economies saw activity levels plummet beyond the predictions of the most pessimistic pundits, and high-flying emerging markets were also stung severely. The freefall is over, and the relief is obvious. Hurdle two was also cleared, but we're still dazed. Now there's a third to handle. Unemployment is rising sharply in many markets. So far, the effects have been manageable, but job losses have yet to peak, and discouraged workers are leaving the market. We've taken the leap, but this critical hurdle has yet to be cleared.

Current position

Where does this leave us? We're in mid-race and operating at a much lower level of economic activity. Signs of growth have brought a lot of comfort, but for the most part, the growth has been tepid and tentative – far from the convincing surge of a true recovery. Furthermore, analysts are having difficulty separating the effects of temporary stimulus measures from a resurgence of fundamental demand. The consensus is not bullish. Most forecasters expect that the major economies will muddle through the coming months, and that performance in 2010 will be anything but spectacular.

Consumers key to recovery

True recovery rests with the consumer. Not the burgeoning consumer class in emerging markets, unfortunately. Although an increasingly significant segment of global demand, these consumers still fall well behind the purchasing capacity of those in larger markets. The global economy is still dependent on big-economy consumers to jump-start global commerce. Is this imminent? By and large, consumers are still deleveraging. Stung by losses in home equity and financial holdings, and faced with labour market uncertainty, consumers are ratcheting up their savings dramatically. As such, consumption is growing more slowly than the recent paltry gains in labour income. And as long as consumers can in part live off their excessive, boom-period purchases, growth is

expected to be weak. It follows that without this key element of demand, international trade flows – also critical to global recovery – will remain suppressed.

Fiscal stimulus will be a big help through the global economy's weak spot. OECD estimates peg the collective stimulus programs of the industrialized economies at just under 4% of their total annual production – substantial by any measure. Emerging markets are also in the mix. China's splashy \$586 billion plan amounts to just over 13% of its annual economy-wide output. Added to the growing momentum last autumn's substantial interest rate reductions are adding to activity, the boost from policy stimulus is significant and timely.

Even so, the massive pump-priming won't keep total global output from suffering an outright decline of 1.3% this year. At first sight, the 2.9% gain projected for next year looks like welcome relief. However, this pace is well below average, and is a fraction of what true recovery growth looks like. What it means is that we'll have to wait until 2011 for a fulsome rebound. The race to recovery is expected to drag on for another demanding 12 months.

Canada remains acutely impacted by the world's economic fortunes. Internally, Canada has fared better than many. However, exports have been battered, suffering a 23% loss in 2009, the worst single year on record by a large margin. In line with the global outlook, exports are expected to post 6% growth next year, a welcome increase, but one that leaves activity in all industries well below 2008 levels. Commodity price increases will favour producers of key primary products, but weak demand and price suppression will crimp growth in the remaining export categories.

Hurdles remain

Key obstacles have been overcome, but the world economy still has a few hurdles to get over. First, financial institutions are not yet through the woods. Recapitalization programs have gone well and confidence has largely been restored. However, the same institutions face rising defaults on existing credits – a direct result of soaring unemployment rates. Those that have conducted realistic stress tests will likely fare well, but there are lingering doubts about the preparedness of others. Further financial market stresses would likely trigger a second round of credit tightening and cause a wobble in confidence, a clear threat to recovery.

A second hurdle is the threat of inflation. Price indexes are bound to jump in the coming months as the

GLOBAL GDP FORECAST BY COUNTRY (Growth)

Top Markets	% Share of World Economy (2008)	Global Outlook (% Growth)		
		2008	2009 (f)	2010 (f)
NAFTA	24.9	0.5	-2.8	2.1
United States	20.8	0.4	-2.5	2.1
Canada	1.9	0.4	-2.3	1.9
Mexico	2.2	1.4	-6.5	2.5
Western Europe	20.2	1.0	-4.1	0.8
United Kingdom	3.2	0.7	-4.5	1.9
EMU	15.3	1.0	-4.2	0.6
Western Europe non-EMU & Scandinavia	1.7	0.8	-3.3	0.2
Japan	6.3	-0.7	-6.0	0.7
Australia & New Zealand	1.3	2.1	0.2	1.8
Asia & Pacific Total	24.5	6.8	4.7	6.5
China, P.R.: Mainland	11.4	9.0	8.0	8.3
India	4.7	7.3	5.8	6.2
Asian NIEs	3.7	2.3	-2.6	4.1
ASEAN-4	3.1	4.8	0.4	4.5
Other East Asia & Pacific	0.5	6.6	4.0	4.9
Other South Asia	1.1	3.7	2.7	3.6
Eastern Europe & Central Asia	8.4	4.4	-7.2	1.0
Russia	3.3	5.6	-8.8	1.4
South America	5.8	5.3	-0.2	2.5
Argentina	0.8	6.8	1.3	2.0
Brazil	2.9	5.1	-0.3	3.1
Central America	0.6	3.3	-1.2	1.4
Middle East & North Africa	4.8	5.9	1.7	3.7
Sub-Saharan Africa	2.0	5.5	0.3	3.9
Industrialized Countries	54.2	0.6	-3.4	1.6
Developing Countries	45.8	6.0	1.2	4.4
Total Global Economy	100.0	3.0	-1.3	2.9

Source: EDC Economics. 2008 is actual data, while 2009 and 2010 are forecast.

The **Asian Newly Industrialized Economies** (NIE) are Hong Kong, Singapore, South Korea and Taiwan. **ASEAN-4** are Indonesia, Malaysia, Philippines and Thailand.

Note: GDP history growth is based on World Bank 2006 PPP estimates.

effect of last year's crash in energy and metals prices wears off. This could trigger concern that would result in an untimely unwinding of stimulus, which would also delay recovery. The threat of protectionism is a third, and potentially monstrous, hurdle. Sadly, protectionist trade actions are gaining momentum, and imperil not just immediate, but longer-term trade performance. Reason is expected to prevail, limiting the effect of this hurdle.

Canadian exporters face a unique hurdle: the currency. At time of writing, the Canadian dollar was hovering in the 97¢ US range, whereas global fundamentals suggest it should be closer to 85¢. Persistent strength of the currency would be damaging to Canadian exports next year, and would hamper Canada's readiness for global recovery.

Key opportunities

Lower global activity levels limit the number of opportunities available at present. Clearly, businesses are cash-constrained and reticent about investment. Bargain-hunting is a global watchword, constraining prices and limiting margins. All told, the environment is tough. But there are pockets of growth that are worth pursuing. Fiscal stimulus has governments the world over spending liberally for the first time in a generation. Infrastructure spending is in vogue, partly to fill in existing gaps and partly to take advantage of new, productivity-enhancing technologies. Many economies are looking externally for the capacity and expertise to deliver on these aggressive plans. Green infrastructure is an especially hot item. Public pressure is the cause in certain economies. In others, especially emerging markets, it is a sustainability issue that the global recession has bought some precious time to address. In many cases, Canada has the technology and expertise to deliver solutions.

Winning projects could gain Canada much-needed exposure in non-traditional markets. These are the markets of the future, and present a great diversification opportunity for Canadian exporters. As the current downturn has once again exposed our vulnerability to key export markets, perhaps a lasting legacy of the recession will be a new focus on non-traditional markets. Sales to these destinations were soaring in the late years of the boom, so diversification had already begun. There's probably no time like the present to launch into these markets ahead of the coming recovery.

A final opportunity is the elusive recovery itself. When it arrives, it is likely to be a strong one. Most seem to have given up on aggressive growth, but the notion is not far-fetched. On a number of fronts, the sharp recession took activity to levels well below what is sustainable. As such, when balance is restored in these markets, consumption and production could easily surge, and those who are prepared for the rush are likely to reap the largest gains.

The bottom line?

The race to recovery will be a tough, 12-month slog. It won't be without key hurdles – but those that make it to the finish will be well placed to reap the gains of a standard recovery growth spurt. At that point, a whole new set of challenges – and opportunities – will emerge.

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CANADIAN EXPORT FORECAST BY SECTOR

Main Sectors	CAD bn (2008)	% Share of Total Exports (2008)	Export Outlook (% Growth)		
			2008	2009 (f)	2010 (f)
Agri-food	42.7	8.1	20.9	-6	1
Energy	134.0	25.5	43.6	-43	9
Forestry	31.2	5.9	-10.4	-18	4
Chemicals & Plastics	37.0	7.0	-2.6	-18	6
Fertilizers	8.6	1.6	86.5	-42	4
Metals, Ores & Other Ind. Products	69.3	13.2	2.9	-31	11
Aircraft & Parts	10.9	2.1	-3.3	3	-11
Rail & other Transportation Equip.	2.4	0.5	12.6	-3	2
Advanced Technology	19.1	3.6	-1.8	-9	-3
Industrial Machinery & Equip.	29.0	5.5	6.1	-9	2
Motor Vehicles & Parts	55.2	10.5	-21.9	-26	16
Consumer Goods	8.2	1.6	-2.7	2	-2
Other*	7.8	1.5	2.1	-24	7
Total Goods Sector	455.4	86.6	8.4	-26	6
Total Service Sector	70.5	13.4	1.2	-4	3
Total Exports	525.9	100.0	7.4	-23	6
Memorandum					
Total Volumes		100.0	-6.5	-15	2
Total Goods Nominal (excl. Energy)	321.4	61.1	-1.7	-19	5
Total Goods Nominal (excl. Autos & Energy)	266.3	50.6	3.9	-17	4

Source: EDC Economics. 2008 is actual data, while 2009 and 2010 are forecast.
*Other includes other industrial goods and special transactions.

Canada's Export Outlook

Canadian exports will record an unprecedented decline this year, as merchandise exports are expected to plummet 26%. The financial crisis that began in autumn 2008, and subsequent freezing of global trade flows, gave way to depression-style industrial production levels and very low consumer and business confidence in the first few months of 2009. As the year went on, financial markets began to stabilize and green shoots were spotted, leading to a recovery in commodity prices, stock markets and the Canadian dollar. However, global demand has yet to rebound and will likely remain depressed through the end of the year. Next year, exports will begin to recover, as positive global GDP growth returns, driven by the industrialized world's significant fiscal and monetary policy response to the downturn.

Energy exports will be the primary drag on total exports this year, as technological advances in the natural gas market result in a shift in the fundamental demand/supply balance, and US demand for crude oil remains extremely weak. Sector exports will grow next year; however, the recovery will largely be price driven.

The dramatic fall in exports of **ores and metals** this year reflects the collapse in developed market industrial production, as well as the bursting of the commodity-price bubble. Very strong demand from Asia for base metals mitigated the carnage, and growth from this region will increasingly influence Canadian export values. However, a real recovery for the sector will occur only when the US and European markets come back next year. A notable downside risk for next year's growth is the *Buy American* provision in the US fiscal stimulus plan.

Canada's **services** sector will weather the storm better than the goods sector; however, it will also experience contraction this year. Travel services will decline both this year and next, as businesses continue to cut back on discretionary spending and personal travel sufferers from tighter border regulations. Transportation services, which are closely tied to trade activity, will take the largest hit,

posting a double-digit decline in 2009, but will recover in tandem with merchandise trade next year. Commercial services, particularly construction and financial services will enjoy a robust recovery next year, as infrastructure spending kicks in and investor activity rebounds.

The year began on a very low note for **motor vehicles and parts** and continued to deteriorate through the first half. The bankruptcy filings of two of the three domestic OEMs in the US was followed by the related bankruptcies of many parts suppliers. While demand for automotive products will improve in the latter half of 2009, thanks in part to the US Cash for Clunkers program, export values will be approximately half their 2007 level. The heavy trucks segment has been very weak as business investment plummets, but should post healthy gains next year as the recovery gains ground and fiscal stimulus packages kick in.

The **agri-food** industry will, on the whole, be less affected by the recession, as processed food exports actually benefit from the US consumer substituting away from restaurant meals. Supply-side constraints pose more of an immediate challenge to the industry, with a double-digit drop in wheat production and herd liquidation in the livestock segment. Next year, exports will be flat as a result of weak yields this season. Meanwhile, fertilizer export values will dive this year, before rising slightly in 2010, moving in line with our price outlooks for agricultural commodities and natural gas.

Exports of **chemicals and plastics** will fall significantly in 2009, as demand-drivers – including industrial production, housing sector activity, auto production and consumer spending on durables – are all expected to be extremely weak. The chemicals industry will benefit from low-input costs, and the pharmaceuticals subcategory will escape contraction. Petrochemical profits, however, will be squeezed as global supply expands. Next year, the industry will experience growth, as US fiscal stimulus spending provides some support to demand.

For the **forestry** sector, 2009 will be characterized by production cuts, driven by mill downtimes and closures, as producers try to keep up with falling demand. Record-low US housing starts are a major drag on lumber prices this year, while falling ad revenues and US newspaper closures hit newsprint demand.

Exports of **industrial machinery and equipment** will drop this year due to sharp cutbacks in business investment. Next year will see a mild rebound as the recovery gains ground. Weak commodity prices, persistently tight credit conditions, and large structural adjustments in

CANADIAN MERCHANDISE EXPORT FORECAST BY COUNTRY

Top Markets	CAD bn (2008)	% Share of Total Exports (2008)	Export Outlook (% Growth)		
			2008	2009 (f)	2010 (f)
NAFTA					
United States	353.3	77.6	6.0	-28	7
Mexico	5.2	1.1	19.7	-19	6
Western Europe					
United Kingdom	12.4	2.7	9.2	-19	5
Eurozone	19.6	4.3	7.5	-14	-1
Other Western Europe	5.6	1.2	-5.0	-35	4
Eastern Europe					
Russia	3.1	0.7	51.7	-29	0
Asia & Pacific					
Japan	10.9	2.4	21.8	-28	-1
China	10.1	2.2	11.8	-5	13
Asian NIEs	7.5	1.6	16.9	-17	4
ASEAN-4	3.4	0.7	37.9	-31	4
India	2.3	0.5	35.8	-18	1
Other Asia	1.6	0.4	14.5	-25	1
Oceania	2.5	0.5	21.8	-16	5
South America (ex. Brazil)					
Brazil	3.2	0.7	20.5	-14	-1
Central America					
Middle East	2.3	0.5	28.6	-6	5
Middle East	4.6	1.0	39.8	12	3
Africa	3.8	0.8	33.8	-8	-2
Total Goods Exports	455.4	100.0	8.4	-26	6
Total Emerging Markets	43.6	9.6	27.9	-13	5
Total to Industrialized Countries	411.8	90.4	6.6	-27	7

Source: EDC Economics. 2008 is actual data, while 2009 and 2010 are forecast.

The **Asian Newly Industrialized Economies** (NIE) are Hong Kong, Singapore, South Korea and Taiwan. **ASEAN-4** are Indonesia, Malaysia, Philippines and Thailand.

worldwide housing sectors are behind the across-the-board drop in all sub-segments. Stimulus spending on transportation infrastructure may provide a boost to **rail and other transportation equipment** exports; however, downside risks persist in the form of protectionism and lack of follow-through on spending announcements.

Advanced technology exports have been vulnerable to the recession due to the sector's exposure to developed markets and business investment activity. Emerging markets are replete with opportunities for the industry, as regulatory and structural changes in countries such as China, India and Mexico provide potential for strong export growth in the future. However, any strength in emerging market demand will be overwhelmed by prolonged weakness in the US market, and exports will contract both this year and next.

Order deferrals and cancellations will result in a contraction in the volume of **aircraft** exports over the forecast. However, 2009 will see a small nominal gain due to the exchange rate effect. In a reversal of recent trends, export growth to emerging markets will be weaker than that to developed markets.

Somewhat counter intuitively, **consumer goods** will receive a boost from the recessionary conditions, as US consumers maintain non-discretionary spending levels. Next year, the industry should resume its long-run trend of decline.

Provincial Export Outlook

While the global economy appears to be bottoming out, Canada's export outlook is far from buoyant. The collapse of commodity prices will result in export declines for provinces more heavily dependent on natural resource shipments this year. Energy- and mining-intensive exporters will lag the national average, with exports out of Newfoundland and Labrador and Alberta plummeting 44% and 36%, respectively. Meanwhile, considerably weakened demand out of Canada's traditional trade partners will impact manufactured goods exports from Central Canada. Prince Edward Island, the only province to show gains in 2009, will see exports grow 4%.

Looking ahead to next year, exports will only partially recover from this year's tumble, posting a comparatively modest bounce-back nationwide. All provinces will see export growth return to positive territory, with no clear distinction between commodity producers and manufacturing-based exporters. Higher prices for forestry products, energy, metals and chemicals will benefit most provinces, although tempered in some cases by weaker

production due to curtailment and shutdowns. New Brunswick will lead all provinces in export growth in 2010, boosted by exports of regasified natural gas. Ontario will also outperform the national average, as demand for automobiles stabilizes after the full stop seen in late 2008/early 2009. The outlook for agricultural commodities will weigh on exports out of the Prairie provinces, dragging down export growth in Saskatchewan and Manitoba.

Exports from **Newfoundland and Labrador** will plunge by 44% in 2009, as a result of the collapse in crude oil prices, declining production at major oil fields, temporary mining curtailments, permanent newsprint closures, and much weaker shellfish prices and landings. Export growth in 2010 will again be impaired by declining output, despite the addition of satellite fields, rising a meagre 2%. Supporting the overall growth will be improvements in crude oil, base metals and shellfish prices, and a slight firming of demand.

With the bulk of **Prince Edward Island's** agri-food exports in the more stable potatoes and downstream processing industries, total exports are expected to buck the national trend this year, despite the sharp decline in lobster prices. Exports will increase 4% in 2009, followed by stable 3% growth next year. The gains will also be supported by growth in the niche M&E and transportation sub-sectors.

Nova Scotia's export decline this year is largely the result of weak fundamentals in the natural gas market, production curtailments in the paper sector, sharply lower prices for shellfish and weaker demand for auto tires. Overall, exports will fall 24% this year, before expanding 9% in 2010. Next year's growth is the result of improvements in energy prices and US industrial activity, combined with a modest recovery in automobile production (boosting tire demand).

In **New Brunswick**, the eventual startup of the LNG plant will not boost exports sufficiently to make up for weaker prices and anaemic demand for refined petroleum products, zinc, potash, shellfish and forestry products. As a result, exports will plunge 29% this year. The province will lead the pack in 2010, however, with 19% growth, as modest improvements in energy and forestry prices are bolstered by a full year of production and exports out of the LNG plant.

Quebec's exports are set to outperform the national average in 2009, as the lag from orders to deliveries in the aerospace sector provides some support. Nonetheless, total exports will fall 17% this year due to the

CANADIAN MERCHANDISE EXPORT FORECAST BY PROVINCE

Provinces	CAD bn (2008)	% Share of Total Exports (2008)	Export Outlook (% Growth)		
			2008	2009 (f)	2010 (f)
Newfoundland and Labrador*	14.6	3.2	26.9	-44	2
Prince Edward Island	0.8	0.2	10.6	4	3
Nova Scotia	5.8	1.3	7.6	-24	9
New Brunswick	12.8	2.8	14.5	-29	19
Quebec	69.3	15.2	3.1	-17	4
Ontario	163.8	36.0	-7.7	-21	8
Manitoba	12.8	2.8	5.2	-17	1
Saskatchewan	29.9	6.6	55.2	-29	1
Alberta	109.9	24.1	34.3	-36	8
British Columbia	33.2	7.3	5.1	-29	5
Territories	2.5	0.5	30.4	-16	9
Total Goods Exports	455.4	100.0	8.4	-26	6

Source: EDC Economics. 2008 is actual data, while 2009 and 2010 are forecast.

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

plunge in aluminum prices, pulp and paper mill closures and weak US-housing construction activity. Despite a better outlook for aluminum exports in 2010, total export growth will be limited to just 4% next year, underscoring ongoing challenges in the forestry and M&E sectors, weaker aerospace deliveries and Buy American provisions at the state government level.

The freeze in credit markets and the ensuing consumer spending collapse has left **Ontario's** auto industry a lot smaller than before. At 21%, however, the drop in total exports will not be as bad as the national average. The US Cash for Clunkers program will offer some temporary relief to the auto sector, while Chinese iron ore demand and high gold prices supported the mining and metals sector earlier this year. Furthermore, exports of pharmaceuticals will remain strong over the forecast period. Next year, we expect export growth of 8%, largely driven by an easing of credit conditions, a partial recovery in the auto sector and, to a lesser extent, higher prices and demand for base metals and industrial chemicals.

Manitoba's agri-food export sector will contract 12% this year, as a result of not only weaker crop prices and demand for pork, but also more stringent labelling regulations in the US. Total exports will fall 17% in 2009, driven by the collapse in energy and base metals prices and metal refinery production cutbacks. With limited upside from the province's main export sectors, export growth will be limited to 1% next year, sustained by the province's niche bus and aerospace sectors, along with higher energy prices.

After surging 55% last year, **Saskatchewan** exports will fall 29% in 2009, as most key commodity prices (including wheat, canola, potash and crude oil) weaken sharply. Fertilizers exports will also contract – both in 2009 and 2010 – due to significant capacity curtailments as producers attempt to balance supplies with demand. Lower fertilizer production, combined with a weaker crop expected this fall, will constrain total export growth to 1% next year, despite higher energy prices.

With the collapse in energy prices, **Alberta's** exports will fall by 36% this year, despite higher production from the oil sands. The fall in energy prices has helped fertilizers and chemicals producers through lower feedstock costs; however, much weaker US demand and prices will dampen exports. Weaker energy prices will also pull down exports of mining and oil & gas M&E. Higher energy prices next year (on an annual average) will provide for a return to growth, with total exports rising 8%. The increase will be moderated by lower crop exports, declining natural gas export volumes and a more challenging environment for the petrochemicals sector due to the significant global capacity expansion.

The decline in **British Columbia's** forestry sector exports will be accompanied by falling energy and industrial goods sales. Sharply lower prices for natural gas and coal, combined with weaker US industrial activity and Asian coal demand, will push total exports down 29% in 2009. Next year, expected improvements in US housing construction activity will prop up lumber and forestry exports, although the pulp and paper sectors will still see little momentum. Also supporting a 5% increase in export receipts next year are recovering natural gas prices and improved Asian demand for metallurgical coal.

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Fall 2009 Global Export Forecast

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