

Global Export Forecast | Summer 2008

EDC Economics

Canada 

 EDC

GLOBAL EXPORT FORECAST – JULY 2008

Contents

1. Canadian Export Outlook	2
1.1 Export Outlook	2
Since our Spring Global Export Forecast, there has not been much in economic news to brighten the spirits of Canadian exporters. So far this year, exports have been uninspiring. But we expect merchandise exports to jump by 5% in 2008, on the back of soaring energy prices. As key commodity prices pull back in 2009, export earnings are forecast to decline 1%. Emerging markets will continue to drive demand this year, before succumbing to the global slowdown.	
1.2 Canadian Dollar Scenario	3
With currency movements being strongly dictated by interest rate differentials, the Canadian dollar will trade around parity with the US dollar during the summer period, before beginning to pull back by year-end and trade in the range of USD0.97 to USD0.94 during the first half of 2009.	
1.3 Trade Confidence Continues to Decline, but Exporters Adjust Expectations	4
Exporter confidence fell again in the spring, sliding to a new all-time low. EDC's latest Trade Confidence Index (TCI) declined slightly from its previous reading, to reach a low of 66.1. But while the outlook remains bleak, the decline in confidence was less severe than that witnessed in our Fall TCI. The message here is that negative prospects appear to be stabilizing, as exporters adjust their expectations in these challenging times.	
2. Developed Markets.....	5
The US housing market is in the doldrums, and prices have further to fall. The consumer remains saddled with mortgage debt, imports are slowing, and weakness is expected to spread to the rest of the world. Japan and the UK continue to flirt with recession, and the growth outlook for the euro zone has softened. While exporters linked with automotive producers and the housing sector will be most at risk, export prospects in developed markets are weak.	
3. Emerging Markets.....	7
Emerging markets will provide some relief to exporters in 2008, showing the largest percentage gains. With improved debt profiles, certain countries are working hard to address legacies of underinvestment by ramping up infrastructure spending. But as the slowdown goes global, we expect even emerging market demand to recede, especially as central banks raise interest rates to counter the effects of rising commodity prices.	
4. Exports by Industry Sector.....	9
On a sectoral basis, robust global demand for grains and high prices should help buoy the agri-food and fertilizer sectors. Exports of industrial commodities continue to benefit from soaring prices, but a correction next years should pull earnings down. Weakness continues to be concentrated among forestry, automotive and consumer goods – areas that rely heavily on the struggling US market. The expected drop in the Canadian dollar, however, could provide some relief in 2009.	

GLOBAL EXPORT FORECAST – JULY 2008

1. Canadian Export Outlook

1.1 Export Outlook

Since our Spring Global Export Forecast, there has not been much in economic news to brighten the spirits of Canadian exporters. Losses due to the sub-prime crisis continue to mount, soaring commodity prices are biting into disposable incomes, and economic data point to slowing global production.

In the US, consumer confidence is in free-fall, hovering just above all-time lows, with no signs of imminent stabilization. The erosion of consumer demand has led to a more generalized slowdown in the US economy, the effects of which have already begun to wash onto the shores of other markets. Japan and the UK may not be able to avoid recession, and the outlook for the euro zone has softened. With over half of world production in the doldrums, emerging market growth, while still strong in comparison, will not be able to buck the trend. This is especially true given that monetary officials have no other choice but to tighten the reins in order to combat surging prices, even as demand continues to weaken.

Inflationary pressures now pose a growing risk, as prices for many industrial and agricultural commodities have reached record levels. Another key concern remains the tightening credit environment – a direct consequence of financial turbulence – which has wreaked havoc in most major markets. While worries over a total financial system meltdown have eased, and observers appear to have adjusted their expectations appropriately, deleveraging of the global banking system continues, and weak credit growth will continue to plague consumers, businesses and government alike.

Deteriorating demand fundamentals are already taking a bite out of Canadian export sales. So far this year, Canadian exports have been uninspiring, even showing a slight contraction in year-over-year terms. But we believe that natural gas and coal price increases will begin to feed through in the second half of the year. As such, we expect merchandise exports to jump by 5% this year. Netting out the influence of prices changes, however, export volumes are set to contract by 4% in 2008. Some recovery in global demand late next year will help pull export volume growth back into positive territory. But a correction of key global commodity prices will translate into a 1% decline in Canadian export earnings.

Underlying these aggregate numbers is a mixed performance across the various industry sectors. The agri-food sector should continue to perform well through the forecast horizon, thanks to robust global demand for grains and high prices. Likewise, fertilizer exports are benefiting from high levels of global crop and biofuel production. After a strong showing in 2008, weaker global demand and increased supply will lead to a correction in energy and metals prices. While still above historical averages, these price declines should pull down export earnings next year.

Table 1: Canadian Export Forecast by Sector – July 2008

Main Sectors	CAD bn (2007)	% Share of Total Exports (2007)	Export Outlook (% growth)		
			2007	2008(f)	2009(f)
Agri-food	35.2	8.4	10.6	5.0	4.7
Energy	91.7	21.9	5.1	38.7	-6.9
Forestry	34.8	8.3	-11.9	-12.0	10.2
Chemical and Plastics	38.0	9.1	5.4	-9.4	-3.2
Fertilizers	4.6	1.1	16.7	78.0	2.8
Ores and Metals	60.0	14.4	13.5	6.8	-8.1
Aircraft and Parts	11.2	2.7	9.5	2.5	3.9
Rail and other Transportation Equip.	2.0	0.5	3.3	-3.8	5.8
Advanced Technology	19.5	4.7	-4.7	-11.0	-2.7
Industrial machinery and Equipment	27.3	6.5	2.5	-3.1	3.4
Motor Vehicles and Parts	70.5	16.9	-6.8	-13.3	2.4
Consumer Goods	8.5	2.0	-11.8	-18.0	-4.0
Other	6.7	1.6	-3.7	-6.2	5.7
Total Goods Sector	417.8	86.1	1.6	5.0	-1.7
Total Service Sector	67.3	13.9	0.1	-0.6	2.1
Total Exports	485.1	100.0	1.3	4.2	-1.2
Memorandum					
Total Volumes (net of prices)			0	-4	1
Total Prices			1	8	-2
Total Goods (excl. Energy)	326.1	67.2	1	-5	0.4
Total Goods (excl. Autos & Energy)	255.6	52.7	3	-2	0.0

Source: EDC Economics. 2007 is actual data while 2008 and 2009 are forecast.

GLOBAL EXPORT FORECAST – JULY 2008

The ongoing slump in the US housing market, sagging consumer confidence, job losses, tighter credit conditions and higher gasoline prices are having a severe impact on exporters in the forestry and automotive sectors. While the outlook for the forestry sector in 2009 is more promising – the result of a weaker Canadian dollar and higher price responses to supply management efforts – the number of passenger vehicles exported is not expected to rebound by much. The strong Canadian dollar, downward price pressures, a weaker consumer around the world and the sharp slowdown in the US economy are also having a negative impact on the advanced technology and consumer goods sectors. The only positive here is the expected drop in the Canadian dollar. Canadian aerospace exporters appear to be defying the odds by successfully managing downward pricing pressures, maintaining decent order books.

On a geographic basis, most of the export strength this year will continue to come from non-US markets, with developing markets showing the largest percentage gains. Countries such as Brazil, China, India, and Russia are still showing strong increases, while traditional markets like the US, the EU and Japan are struggling. As the slowdown goes global, however, we expect even emerging market demand to pull back.

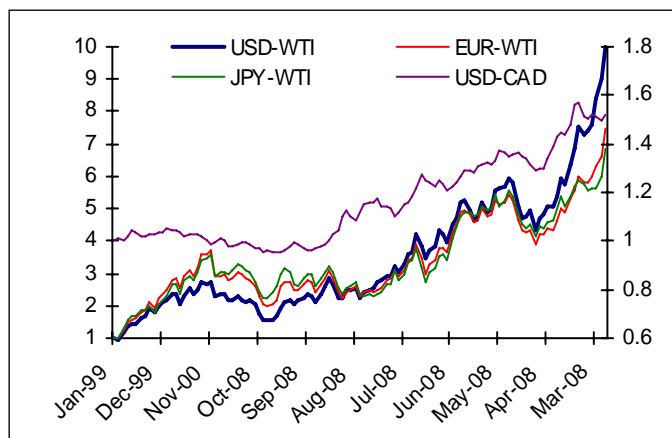
1.2 Canadian Dollar Scenario

The Bank of Canada is on pause, choosing to not lower the policy interest rate further due to the threat posed by relative-price pressures to total consumer price inflation and inflation expectations. This does not necessarily signal the end of the easing cycle – although we are not far from it, at 3% (1% real). If energy prices crash below what we assume in our baseline scenario, there could be scope for additional cuts of 25 to 50bps later this year. However, we do not anticipate any further changes to policy for the remainder of 2008 and the first few months of 2009. Beyond that, we assume some gradual tightening of policy, to the tune of 125bps. The extent of monetary tightening next year will depend on demand and supply balances in the economy, and on inflation expectations. For now, though, monetary policy is sufficiently accommodative to balance aggregate demand and supply, and to achieve the 2% CPI inflation target over the medium-term.

Since the start of 2007, the US currency has exhibited significant weakness, evident by the widening spreads between USD-WTI and the EUR-WTI and JPY-WTI price indices (see figure 1). We also notice that the Canadian dollar has lost traction, no longer rising in tandem with USD crude prices, due to interest rate cuts made by the Bank of Canada. In addition, weak US housing and auto markets have had a substantial impact on Canadian industrial production and exports, and now the overshoot in USD energy prices is threatening a more severe US downturn. This could further impact export volumes and Canada's trade surplus position, putting added downward pressure on the Canadian dollar.

Once slowing economic growth becomes more global later this year and into next, followed by lower ECB short-term interest rates, then market sentiment towards the US economy will switch, signaling a turning point for the US dollar. Easing global demand and a retreat in USD commodity prices will ensue, helping to deflate the Canadian dollar, as will relatively lower short-term interest rates and a shrinking trade surplus. Overall, the Canadian dollar will trade around parity with the US dollar during the summer period, before beginning to pull back by year-end and trade in the range of USD0.97 to USD0.94 during the first half of 2009. Risks to our dollar outlook are tilted to the downside due to the vulnerability of USD commodity prices to easing global demand growth.

Figure 1: Crude Oil Price Indices by currency & Canadian-US Dollar Movements



Source: Statistics Canada, EDC Economics

1.3 Trade Confidence Continues to Decline, but Exporters Adjust Expectations

Exporter confidence fell again in the spring, sliding to a new all-time low. EDC's latest Trade Confidence Index¹ (TCI) declined slightly from its previous reading, to reach a low of 66.1 (see Figure 2). Weakening US and Canadian economies, a strong Canadian dollar and financial market turbulence were most often cited as the major obstacles facing Canadian exporters. But while the outlook remains bleak, the decline in confidence was less severe than that witnessed in our Fall TCI. The message here is that negative prospects appear to be stabilizing, as exporters adjust their expectations in these challenging times.

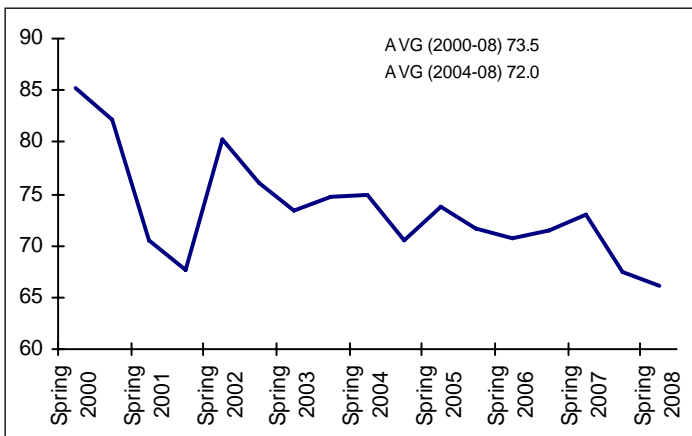
The loonie is still a big problem for exporters. The percentage of survey respondents highlighting the importance of the Canadian dollar in their ability to compete in foreign markets remained high, at 61%. This was down slightly from 66% in the previous survey, a sign perhaps that exporters are simply pricing-in the risks posed by currency movements. Indeed, almost half of those surveyed are either cutting costs or increasing export prices in response. Many, meanwhile, continued to indicate that they are simply absorbing the losses by allowing the stronger currency to eat into profit margins. Still others are reconsidering their business models outright, looking to focus more on domestic sales for example.

How long can exporters withstand their profit margins being squeezed? Well, it will have to be a little longer. With the Canadian dollar still hovering above parity, most exporters do not anticipate relief in the near-term. The majority, 62%, expect the dollar to remain at its current level for the next six months.

Exporter sentiment was down across all regions of Canada, with Atlantic Canada showing the largest decline. At the provincial level, seven provinces saw declining exporter confidence, while Ontario remained relatively flat, and New Brunswick and Saskatchewan saw slight increases compared to the previous survey.

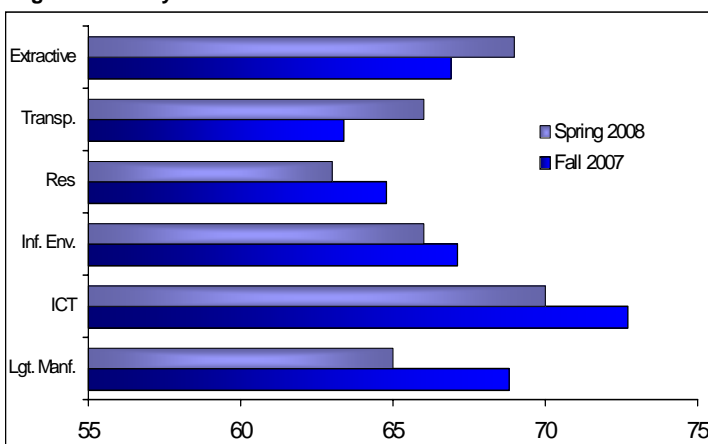
On a sectoral basis, the results are less dire than they were six months ago, when all six sectors registered a decline in their trade confidence. In fact, there were even two sectors that showed more optimism than in the previous survey – transportation and extractive. The extractive sector's optimism is not surprising, given record-high prices and greater export volumes. The upward swing in the transportation sector, by contrast, is more difficult to explain. Certainly, the automotive sector is struggling, as exports continue to decline. But there are sub-sectors such as aircraft and other transportation equipment that saw their exports increase in 2007. In addition, ongoing investments in emerging markets could be contributing to the transportation

Figure 2: TCI Composite (2000-2008)



Source: EDC Marketing and Database Team

Figure 3: TCI by sector



Source: EDC Marketing and Database Team

¹ The Trade Confidence Index is a semi-annual survey of exporters' confidence about the future of the trade environment. It is a composite score based on responses to five questions about future global and domestic sales, economic conditions and trade opportunities. These latest findings are based on 850 responses to a telephone survey in April/May 2008.

GLOBAL EXPORT FORECAST – JULY 2008

sector's improved outlook.

Meanwhile, the low trade confidence expressed by the resources and light manufacturing sectors is not unexpected. Both these sectors struggled in 2007, experiencing declining exports and profits due to factors such as the high Canadian dollar, diminishing demand in the United States and higher energy costs. These factors will likely persist in 2008 – providing little or no relief for these two sectors.

It is no surprise that the United States is the preferred export market among those surveyed. However, current economic conditions in developed countries are influencing Canadian exporters' risk perceptions when it comes to traditional markets. In fact, the US is considered to have the second highest risk profile of all export markets by Canadian exporters, behind only Asia. This US risk perception has increased over time, going from 5% in the Spring 2006 TCI to 25%, currently. The region that experienced the largest shift in risk perceptions from the previous survey was the European Union – going from 5% in the Fall 2007 TCI to 15%. As a result, Canadian exporters continue to diversify their export markets, seeking trade opportunities in countries that go beyond their traditional trade partners.

2. Developed Markets

The outlook for developed markets is similar to our Spring Global Export Forecast. The US housing market is in the doldrums, and prices have further to fall. The consumer remains saddled with mortgage debt, imports are slowing, and weakness is expected to spread to the rest of the world. Japan and the UK continue to flirt with recession, and the growth outlook for the euro zone has softened. Taken together, GDP growth in developed markets is forecast to slow from the 3%-rate of expansion between 2003 and 2007 to 1.8% in 2008 and 2009.

While commodity prices and our outlook for financial markets remain key risks to the forecast, greater inflation risk is now a growing concern. The inflation threat is largely a commodities problem brought on by China's overheating and the falling US dollar. Prices for oil, steel, coal, iron ore, fertilizers and many agricultural products have all reached record levels. While the inflation threat is real, so far there has been little pass-through of higher prices into core inflation or wages and inflation expectations for the most part are grounded. Although food price inflation is likely to persist throughout the forecast period, other key commodities such as crude oil and metals are poised for a correction. We believe that investors have over-brought crude oil, too focused on seeking a safe haven from a falling US dollar rather than reacting to real supply and demand issues. Indeed, daily movements in the price of crude and the USD/EUR exchange rate show a 40% correlation between the two series year-to-date, compared with an historical average of around 5% going back to 1999.

While concerns of a global financial system meltdown have eased, this downside scenario has not yet been put to rest. De-leveraging of the global banking system continues, and a direct implication of this is lackluster credit growth of a potentially long duration. Bank losses totaling nearly USD400bn to-date, and ongoing unwinding of excesses in debt, consumption and housing, means the global re-pricing of risk remains intact. Generally speaking, corporate balance sheets are in good shape, but highly leveraged and highly speculative companies face a liquidity squeeze and significantly elevated interest rates. More financial uncertainties are looming.

There are plenty of risks to our forecast, but our base-case scenario calls for slower global growth accompanied by falling interest rates in Europe and slightly higher interest rates in the US later this year and in 2009. These policy shifts will halt the dollar's decline against the euro, but less so against emerging market currencies due to a general tightening of monetary policy in key markets. The global slowdown, bottoming of the USD and reduction of oil price subsidies in Asia, will work together to bring down prices of non-agricultural commodities.

US real GDP grew only 1% annualized q/q in the first quarter of 2008, as consumption grew at its slowest rate since 2001 and residential investment in each of the last two quarters fell by the most since 1981. Higher frequency economic data suggest some upside risk to our baseline growth assumption in the second quarter, but we see little evidence that the US is soon set to break out of its economic slump. Indeed, overall growth is forecast at 1.6% in 2008 and 1.6% in 2009, well-below estimates of potential growth.

The consumer, 70% of US GDP, remains at the eye of the storm. Confidence surveys point to a consumer recession, with record gasoline prices chewing into disposable incomes. Keep in mind that every one-cent increase in the price of gasoline costs consumers an extra US\$1.3-1.4bn per year. Moreover, consumer credit growth is unlikely to spur spending in light of tighter bank lending standards and falling household net worth from

GLOBAL EXPORT FORECAST – JULY 2008

declining home prices. Finally, with the ratio of household debt to personal disposable income hovering near record levels, consumers will ultimately have to increase their saving rate, implying reduced spending on consumer goods such as cars, furniture, restaurants and clothing.

Housing starts are down 50-60% since January 2006, and while inventories of new homes have fallen 20% from their peak, inventories of existing homes hover near record levels. Excess housing supply is driving prices down and eroding household net worth across much of the US. Housing starts may bottom before year-end but we expect no recovery over the forecast. Past housing corrections have shown that real price declines can last anywhere from three to five years and we are only two years into the current correction.

Manufacturing continues to get a lift from solid exports, but weak US consumption – durable goods, in particular – suggests little upside for the sector. Already, vehicle sales are shaping up to make 2008 the worst year since 1995. This outlook, along with US small business sentiment near a 20-year low, implies little upside for investment in machinery and equipment.

The slowdown in consumer demand and investment means that real imports will fall this year, with another likely decline in 2009. This weakness will eventually wash onto the shores of foreign countries, but with a lag. Already, import growth from China has slowed considerably, dropping from over 20% annually between 2002 and 2006, to around 4% more recently.

The US Fed is likely to increase interest rates by 25bps this year and another 50bps in 2009. Chairman Bernanke will clearly communicate his intentions, recognizing surprises are not welcome given current market stresses. All the while, we expect the central bank to continue to provide for non-traditional direct liquidity arrangements to areas of the financial market showing the greatest strains, in order to prevent more systemic risks.

The euro zone grew 2.6% in 2007, down slightly from 2.8% in 2006, but stronger than estimates of potential growth. With capacity pressures already in the system, the unanticipated sharp climb in global food and energy prices has driven consumer price inflation well above the ECB's threshold of 2%. Ever-cautious of inflation, the European Central Bank (ECB) has done little to boost the economy, even as the US Fed chopped interest rates 325bps in the last year alone. The result has been a surging euro, which is now weighing on exports. Industrial production has fallen, consumer and business confidence continues to wane, and housing market corrections are advancing in the UK, Spain and Italy.

Overall, modest euro zone domestic demand growth and sober export growth will combine to generate real GDP growth of 1.6% in 2008 and 1.4% in 2009. The balance of risks to the Euro Area outlook is to the downside, with financial and external risks outweighing an already modest regional domestic demand growth outlook. Further financial losses to European banks risk additional blows to bank capital that could heighten the negative impact on lending for business and residential investment. A deeper and more protracted period of economic weakness in the US could also have greater direct and indirect consequences for euro zone growth.

In Asia, Japan cannot be counted on to add to global growth. Growth prospects are hinged almost entirely on its outlook for exports, which in light of the relatively strong yen and anticipated global slowdown, are not great. The reliance on external demand for economic growth is a result of bleak prospects for any substantial revival in domestic spending. Even manufacturing a temporary boost to growth via fiscal or monetary policy tools is limited given high government indebtedness and near-0% official interest rates. Despite a surprisingly strong start to the year, leading and coincident indicators, along with business and consumer sentiment, all suggest that recession is likely.

Easing global demand, led by US economic weakness, will limit Canada's economic growth. Exporters linked with automotive producers and housing markets will be most at risk. Exporters of primary resources should continue to experience fairly strong demand, particularly from emerging markets. With robust Canadian domestic demand and strong import growth, weaker exports will result in further negative contributions from net exports to real GDP growth. As a result, real GDP growth is forecast to expand by only 1.1% in 2008 and 2.0% in 2009.

GLOBAL EXPORT FORECAST – JULY 2008

3. Emerging Markets

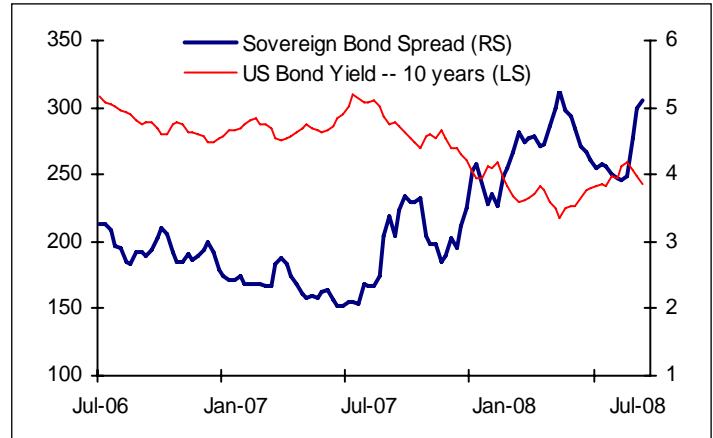
Emerging market (EM) prospects are unfolding roughly as expected – GDP growth is slowing, inflationary pressures are growing and credit rationing is underway. Central Banks are reluctantly raising interest rates to tamp down surging energy, food and other commodity prices at a time when demand is slumping. The result is faster inflows of capital to some markets, as international investors look to diversify away from low-yielding USD assets. EDC Economics is projecting growth will slow to just under 7% this year and 6.4% in 2009 – though the outcomes will vary across markets.

In the face of global credit rationing, EM bond spreads have widened on average 140bps from a year ago. But not all countries have been hit equally. Countries with large short-term debt obligations and/or large current account shortfalls – like Argentina, Lebanon and Turkey – are seeing the greatest impact. Others like Brazil, China, and Russia have experienced a more muted response. Previously these deficits were funded by a combination of net FDI and steady portfolio inflows, and that still holds true in some cases. But for some EMs these shortfalls have widened sharply alongside more costly capital.

Slower EM growth should lead to weaker demand for imports of goods and services, but that is just part of the story. Many of these markets have taken the past five years to improve upon their debt profiles – which means that they face the next few years with stronger credit positions. Further, those countries with legacies of underinvestment are now beginning to address capacity shortfalls and bottlenecks. The Middle East and, more recently, Africa are on a spending tear for everything from transportation, communication, sanitation and energy infrastructure to office buildings, petrochemicals, and engineering and management services.

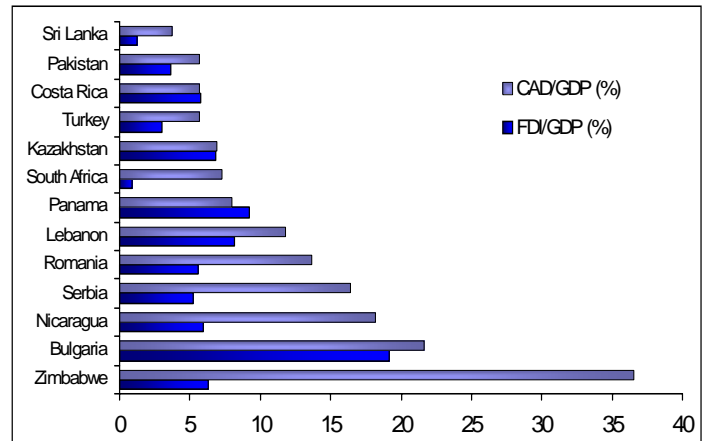
Variations of this trend exist in almost every EM around the world. But some estimates suggest that emerging economies together are likely to spend over USD1 trillion on infrastructure projects this year, and over USD20 trillion over the next 10 years. Canadian exporters are well-placed to benefit from this spending spree. Indeed, exports to EMs will continue to outperform sales to developed markets.

Figure 4: Bond Spreads Are Half of the Story



Source: Bloomberg.

Figure 5: Current Account Deficits a Growing Concern



Source: EIU, EDC Economics / Footnote: CAD/GDP is Current Account Deficit/GDP. FDI/GDP is Net Foreign Direct Investment (inflow)/GDP

Table 2: Future Business Prospects....

Regions	Top Sectors
Central & Eastern Europe	Engineering services, industrial machinery and equipment (agricultural, energy, transportation), telecommunications equipment, meat
Latin America & Caribbean	Machinery and equipment, telecoms and computer equipment, construction and engineering services, commercial services
Asia*	Chemicals, pulp, wheat farming, metals, newsprint, oilseed and pulse, fertilizers
Middle East & North Africa	Engineering/financial/managerial services, industrial machinery and equipment (agricultural, energy, transportation), agricultural products, telecommunications equipment
Sub-Saharan Africa	Engineering/managerial services, airplanes and parts, agricultural products, industrial goods and machinery (agricultural, construction, energy)
Brazil, Russia, India, China, Mexico	Energy, wheat farming, industrial goods, other agricultural machinery and equipment

Source: EDC Economics. *Developing Asia refers to all Asian countries except Japan, Hong Kong, Singapore, South Korea and Taiwan

GLOBAL EXPORT FORECAST – JULY 2008

Table 3: GDP Outlook by Region (% Growth)

Top Markets	2006 PPP GDP, bill International \$	% Share of World Economy (2007)	Updated Outlook (% growth)		
			2007	2008(e)	2009(f)
NAFTA	15,072	26.12	2.4	1.6	1.8
United States	12,696	22.01	2.2	1.6	1.6
Canada	1,156	2.00	2.7	1.1	2.0
Mexico	1,221	2.12	3.3	2.5	3.2
Western Europe	12,391	21.48	3.0	1.7	1.5
United Kingdom	1,941	3.36	3.4	1.6	1.5
Eurozone	9,437	16.36	2.8	1.6	1.4
Other West Europe	1,013	1.76	3.2	2.2	1.7
Japan	3,925	6.80	2.3	1.4	1.6
Australia & New Zealand	787	1.36	4.5	2.8	2.7
Asia & Pacific total	13,150	22.79	9.1	8.0	7.7
China,P.R.: Mainland	5,881	10.19	11.8	10.2	9.5
India	2,549	4.42	9.2	8.1	7.5
Asian NIE's	2,135	3.70	5.0	4.4	4.8
ASEAN-4	1,767	3.06	5.9	5.6	5.8
Other Asia	202	0.35	8.4	7.1	7.7
Other South Asia	616	1.07	6.6	5.5	6.1
Cent. & Eastern Europe	4,473	7.75	7.1	6.1	5.4
Russia	1,798	3.12	8.1	7.5	6.2
South America	3,235	5.61	5.9	5.0	4.2
Argentina	451.7	0.78	8.7	6.0	4.0
Brazil	1,632	2.83	5.4	4.5	4.1
Central America and the Caribbean	323	0.56	5.8	4.9	4.3
Middle East & North Africa	2,730	4.73	5.9	6.2	5.9
Sub-Saharan Africa	1,093	1.90	6.7	6.7	5.8
All Others	515	0.89	4.9	3.9	3.7
Industrialized Countries	33,089	57.4	2.8	1.8	1.8
Developing Countries	24,605	42.6	7.8	6.9	6.4
World Total	57,694.31	100.00	4.9	3.9	3.7

Source: EDC Economic Analysis and Forecasting Team. 2007 actual, 2008 and 2009 are forecast. Asian Newly Industrialized Economies (NIE) are Hong Kong, Singapore, South Korea and Taiwan.

GLOBAL EXPORT FORECAST – JULY 2008

4. Exports by Industry Sector

Energy – Energy exports are expected to rise almost 40% this year, before falling 7% in 2009. This year's figure has been revised up significantly to reflect our new forecast for crude prices (USD110/barrel in 2008 and USD84/barrel in 2009) along with higher prices for natural gas.

While it is true that global supply and demand for crude is tight, there are signs that a large price correction is on the horizon. On the demand front, growth expectations are likely to moderate as the global slowdown spreads and oil price subsidies in emerging markets are eased. On the supply front, the EIA is already forecasting a doubling of OPEC surplus capacity, to 4mn barrels per day in 2009, and non-OPEC supply gains of 1mn bpd. Furthermore, EDC does not subscribe to the peak oil theory. Indeed, during the last price spike (early 1980's) proven global reserves were equal to 30 years of consumption. Fast forward to 2007, and despite a 40% increase in consumption, current reserves are equal to over 40 years of consumption. Finally, there is the speculative component to oil prices, and this is a key forecast risk. EDC Economics suspects the recent run up in oil is a result of speculative investors seeking safe haven from a falling US dollar. Indeed, so far in 2008 the correlation between crude oil and the USD/EUR has been 40%, versus the long term average of 5%. If the USD stops falling against the euro, look for sophisticated speculators to exit crude and prices to fall accordingly.

After working off a considerable inventory overhang in the US, natural gas prices have surged. However, although inventories are down on the year, they are still near the five-year average and so here too, price gains are likely overblown. Our current forecast calls for Henry Hub natural gas to average USD10.5/MMBtu in 2008 and USD9.1/MMBtu in 2009, up significantly from our Spring Global Export Forecast. Higher prices have already halted the decline in Canadian rig activity, and we are revising up our volume forecast slightly. A large boost to volumes will also come in 2009 on LNG shipments from New Brunswick.

As the price of metallurgical coal soars this year Canadian exports will rise a whopping 70%. The price story is the culmination of strong demand from China and supply problems in Australia. As conditions normalize, we expect prices to fall considerably in 2009. Finally, we expect electricity exports to grow by an upwardly revised 11% in 2008 and 6% in 2009.

Metals and Ores – The outlook for refined metals and metal ores remains broadly supportive, with vigorous foreign investment and economic development in emerging economies the impetus for solid global demand over the next few years. Even so, weakening growth in Western European and the US will indirectly slow metals demand somewhat in emerging economies. On the supply side, the lagged investment response to high metal prices will bite late this year and press down harder during 2009 – although metal prices are forecast to remain well-above the lows recorded in recent business cycles. Further depreciation of the USD may keep prices at current levels, but beyond year-end – with US short-term interest rates rising – we anticipate a long-overdue downward correction in metal prices. Our forecast for Canadian exports of ores and metals has been revised up for the year (7%) before a retreat in pricing results in exports falling back 8% in 2009. Lower metal prices explains the bulk of the decline next year, with depreciation of the Canadian dollar helping to buffer the fall. In terms of shipments (quantity of ore and metal), global demand will remain strong in 2008 and 2009.

Copper fundamentals remain broadly supportive this year and next, but growing concerns over the US economy and slowing demand elsewhere in the world have clouded the outlook. In addition, the complex interplay between China's refined consumption, use of scrap, production and strategic stockpiling adds uncertainty. We forecast LME spot copper to average USD7,350 m/t in 2008 and USD5,520 m/t in 2009.

Aluminum has and will continue to remain in a position of moderate over-supply despite strong global demand. Lower prices of metallurgical alumina, together with historically high aluminum prices, have encouraged stronger production. For now, Chinese consumption is absorbing still-strong increases in production, thanks to a boom in Chinese industrial and infrastructure activity. China's net export position in the coming years, and its impact on global prices, will be a key consideration. We forecast LME spot aluminum to average USD2,480 m/t in 2008.

The nickel market has undergone a transition due to curtailments in stainless steel production together with shifts away from austenitic stainless steel. Furthermore, the past appreciation in nickel's price has encouraged new production; most notably commencement of nickel mining operations at Ravensthorpe (Australia) and soon to commence operations at Onça-Puma (Brazil) and Goro (New Caledonia) in early 2009. As such, we expect nickel surpluses for 2008 and 2009.

GLOBAL EXPORT FORECAST – JULY 2008

Aerospace – Canadian exporters in the aerospace industry are facing increasing pressures to reduce prices and remain competitive. Overall, the sector has seen prices fall 8% so far this year. On the upside, companies have been able to successfully manage these pressures and increase shipments by 11% between January and April. Our forecast has been revised to reflect the assumption that prices will remain lower than last year, and that orders, although weakening over the forecasted horizon, will remain in decent shape. As a result, we now expect export earnings to grow 3% in 2008 and 4% in 2009.

The main downside risk to our forecast resides in the fact that if energy prices keep increasing, carriers around the world would start scaling back, and new orders placed to Canadian companies could be cancelled or deferred. That said, so far, so good. Bombardier's backlog has not been affected by airline downsizing. To the contrary, the company has recently announced that profits have tripled thanks to an increase in deliveries, and that new orders remain solid. Moreover, the company expects deliveries of luxury jets to rise by 33% between now and 2017. This is the result of a strategy of diversification of sales to markets outside the US, going from a share of 70% of total orders in 2003 to around 33% last year.

In terms of technologies, developments so far seem to indicate that we were correct in expecting that the larger regional jet and turboprop segments would continue to show strength. But we may have overestimated the impact of the global slowdown on business jet orders. If orders in this segment are maintained, it may prove to be a boost to the overall sector though our forecast horizon. On the flight simulators segment, CAE has revised up its sales' prospect for this year.

Finally, we continue to believe that aside from fierce competition from other companies around the world, emerging markets offer the best prospects for Canadian exporters in the aerospace industry.

Motor Vehicles and Parts – US light vehicle sales on a monthly year-over-year basis have been declining for the last several months, with sales falling 13% y/y in June to well under 14 million units – compared to the five-year historical average of 16.6 million units. Light truck sales explain the bulk of the declines, with car vehicle sales going sideways. This poor sales performance reflects the ongoing slump in the US housing market and consumer confidence, job losses, tighter credit conditions and higher gasoline prices. The impact on Canadian manufacturers and exports has been severe, with no immediate relief in sight. Canadian year-to-date production and export shipment figures tell the story well, both down a massive 18% YTD (April). Passenger car production is down 12%, with export shipments down 8%. Light truck production has fallen 23%, with total truck (light and heavy) exports 54% lower. Preliminary production figures for May reveal more of the same pain.

Against the backdrop of declining sales, head corporate offices are anticipated to trim back passenger car production in an effort to manage days of product inventory. EDC economics expects US light vehicle sales to remain below 15 million units during the remainder of this year. As a result, cutbacks in production will cause passenger car exports to fall by 14% in 2008. In 2009, the number of passenger vehicles exported is not expected to rebound, with exports advancing a modest 2%.

The challenges facing Canadian automotive parts producers have increased in tandem with production cuts at North American vehicle plants. Given that US and Canadian vehicle production is not expected to rebound anytime soon, parts producers will experience declining orders across the board. Already, shipments of motor vehicle parts have fallen sharply, driving exports down 17% YTD. Overall, Canadian exports of automotive parts are forecast to decline 12% in 2008. Currency depreciation next year will help improve export revenues, but competition from low-cost producers will limit any upward movement in producer prices. As a result, parts exports are forecast to rise only 2% in 2009.

Medium- and heavy-duty truck export revenues fell almost 46% in 2007, and production figures thus far have been weaker than anticipated earlier. Although the outlook for heavier trucks is not as grim as elsewhere in the industry, and some pent-up demand will act to partially offset the dampening effect of a slowing US economy. As such, Canadian heavy truck exports are forecast to decline 5% in 2008 before recovering somewhat in 2009.

Rail & Other Transportation Equipment (excluding autos and trucks): On the back of a 9% decline in 2007, exports of railcars and related rail equipment plunged a very pronounced 26% y/y during the first four months of 2008. Shipments to key markets (US, EU, UK, Mexico and Brazil account for 90% of international sales) are in retreat. However, exports to Africa, Middle East and the ASEAN countries are growing strongly. Most emerging markets as well as many industrialized countries are building or upgrading their rail networks which means

GLOBAL EXPORT FORECAST – JULY 2008

exports, especially to the emerging markets will rebound once the current bout of global credit tightening slows and industrialized countries rebound. Railcar sales will likely slip about 22% this year followed by a 5% gain in 2009. Other transportation equipment exports (RVs, armoured vehicles, ship/boat building and repair) advanced at a 10% y/y clip in 2007, though the pace slowed to 5% y/y in the first four months of 2008. Sales to the US and Africa continued to advance, while shipments to most other destinations were in decline. EDC Economics expects a moderation of these trends in 2008 with export growth of 4% this year and 6% next year. Indeed, this sector continues to benefit from strong global shipping demand.

Consumer goods – Exports of consumer goods have fallen in each of the last six years, and 2008 and 2009 are expected to be no different. Consumer goods lie directly in the flight path of the US slowdown. Roughly 85% of related exports go to that market and housing wares such as furniture, cabinetry and appliances, are among the largest sub-sectors within the basket of Canada's consumer goods exports. Clearly there will be fewer homes to furnish in the US for some time and demand for these products will be soft over the forecast. Moreover, as house prices fall, the number of homeowners with the ability to make home-equity withdrawals to finance current purchases will slow to a trickle. Consumer confidence at recessionary levels, high gasoline prices and year-to-date job losses paint a nasty picture for the US consumer. Meanwhile a tightening of credit standards means other forms of consumer credit can not be relied upon to bridge this financing gap. Recession weary consumers will react to this environment by attempting to stretch their disposable incomes. The knock on affect to Canadian manufacturers of niche or relatively high-end consumer goods will lose ground to lower quality generic goods. Meanwhile producers of textiles and apparel will continue to face stiff competition from off-shoring and globalization. After a disastrous 12% drop in exports last year, consumer goods exports should fall by a downwardly revised 18% in 2008 before dipping another 4% in 2009. The only positive we see for the sector is the expected drop in the Canadian dollar.

Advanced Technology – As predicted in our Spring Global Export Forecast, a strong Canadian dollar, downward price pressures, a weaker consumer around the world and a sharp slowdown in the US economy are having a negative impact on the advanced technology sector. Based on developments in the sector so far this year, we have revised our forecast down for 2008 to -11%, from -7%. Our 2009 forecast remains unchanged, at -3%.

As a result of ongoing mergers and acquisitions in the telecoms sector, prices and volumes fell 7% and 23% year-to-date, respectively. New investment in major telecoms infrastructure replacements and network upgrades are being delayed, especially in developed markets. We expect this negative trend to continue through the rest of this year and into next. Our forecast calls for export earnings to decrease 21% in 2008 and 10% in 2009.

Although prices fell dramatically in the computer and electronic equipment segment during the first quarter of 2008 (-22%), shipments were up 25% over the same period. The net result was a 3% decrease in export earnings. Our forecast calls for prices to recuperate a portion of their losses over the rest of the year and in 2009, and for growth in shipments to moderate. We expect final export growth to be around -7% in 2008 and flat in 2009.

Overall, we still think that emerging markets continue to present the best prospects for Canadian exporters. The best business opportunities will be in India, Brazil, Russia and Eastern Europe. These markets have grown by an average of 16% y/y so far this year.

In terms of technologies, on the telecoms front, exporters of equipment to be used in Wimax and CDMA deployments and FTTx technologies – especially to emerging markets – will see the best results. In the computer and electronic equipment area, semiconductor exports grew 34% in the first quarter of the year and are expected to remain strong over the forecast horizon.

Machinery and Equipment – On the back of a 2.5% expansion in 2007, exports of industrial machinery and equipment (M&E) are slated to decline 3% this year before rebounding 3% in 2008. Oil and gas and agricultural and construction machinery and equipment sales will advance solidly this year. But, the steady performance by these sub-sectors will be insufficient to offset substantial declines in chemicals, rubber, plastics, metal and woodworking machinery. Geographically, while the developed markets are taking a breather, emerging markets continue to drive demand for industrial machinery to meet their growing industry, commercial, construction and infrastructure appetites.

GLOBAL EXPORT FORECAST – JULY 2008

After growing 34% in 2007, exports of mining and oil and gas M&E are expected to rise another 15% in 2008 and 6% in 2009. Notwithstanding our generally bearish outlook for commodities, prices will remain well-above marginal costs, as the global boom in mining continues. US activity remains strong, though export growth to that market will decelerate from the 22%-pace recorded in 2007. EDC Economics anticipates ongoing strength from markets in South America, Eastern Europe and Africa over the forecast period. On the other hand, exports of chemicals and plastics M&E are off to a terrible start, prompting our forecast of a 16% contraction in exports this year. Chemicals and plastics manufacturing is a cyclical industry, and is highly exposed to the key automotive, consumer goods and housing sectors in the US. Meanwhile, massive growth in chemicals production capacity in the Middle East offers growth opportunities for Canadian M&E sales.

Exports of agriculture and construction M&E will rise 3% in 2008, as exports of agricultural machinery offset weaker US demand for construction machinery. In 2009, continued strong prospects for agricultural commodity prices and the weaker Canadian dollar will result in a 5% increase in Canadian exports of agriculture and construction machinery. Exports of metal and woodworking M&E declined 14% in 2007. The lion's share of receipts in this category comes from metal-working equipment. Over 80% of exports are destined for the US, and with an economic downturn underway, this sub-sector is expected to record a further decrease in exports this year. No rebound is expected in 2009, due to soft underlying demand in the US.

Agri-food – Whereas price gains led much of the advance in Canadian agri-food exports last year, rebounding production will have a strong impact in several industry branches through 2009. Export growth in the first four months of the year was healthy, particularly in the case of wheat, coarse grains, oilseeds, and pulses. Continued increases in emerging market protein demand, and the relatively price-inelastic demand for many agri-food products, will buffer the slowing economic prospects of key advanced buyers such as the US, Japan, and the EU. Although expected to slow from an intensive 10.6% nominal gain in 2007 – as prices either decelerate or begin to edge down from record highs – EDC Economics forecasts still-strong export performance of 5% in 2008 and 5% in 2009.

With seeding and production in Canada responding to favourable pricing, wheat exports are forecast to rise 13% in 2009 following a price-induced dip in 2008. The acreage shift will catalyze only a small increase in Canadian barley exports as volumes drop and competition from the EU heightens. Meanwhile, oilseed sales are forecast to rise 38% on the heels of a strong 32% showing in 2007, as the supply of canola meets strong food and biofuel demand, and soybean prices surge. Lower pork production and the implementation of COOL beef labeling will depress meat volumes this year, but 2009 should bring exports back, albeit moderately, into positive territory.

While a row of agricultural commodities has begun to ease from the lofty price peaks reached in March, both pricing and supply will increasingly centre on reallocation of acreage and biting input costs. Cost pressures are expected to fuel live animal and meat price increases as feedlots reduce herds and seek to substitute away from high-priced corn to alternative feed grains. Energy costs, in the form of both fuel and fertilizer, will keep pressure on margins across the sector in 2008, with relief on the way in 2009. Ocean freight rates, which hit records of their own this spring, are expected to trend downward on the back of slower global growth. A strong CAD, meanwhile, will continue to dampen receipts and competitiveness in 2008, though its effect is expected to ebb in 2009 as the loonie finally begins to exhale.

Chemicals and Plastics – Year-to-date exports are in line with previous expectations. We are therefore maintaining our forecast of a 9% drop in exports this year but have downgraded our outlook for 2009 to a drop of 3%. These industries are highly cyclical and each is exposed to key areas of weakness in the US economy, namely autos, consumer goods, housing and general construction. Growth in shipments to emerging markets will provide some lift, but a US recession, and a slowdown in the euro zone, will drive the bottom line. There are also key downside risks for chemicals and plastics including a greater than expected slowdown in global GDP, higher oil/gas prices, a stronger Canadian dollar and continued off-shoring of production to areas like the Middle East (chemicals) and China (plastics). Even if energy prices drive chemicals and plastics' exports higher, companies are likely to see their profit margins squeezed as soft demand limits the industry's pricing power.

Chemicals are highly exposed to the housing market, auto industry and consumer demand. To the end of last year, non-residential construction was providing at least one source of strength but this too will weaken as 2008 wears on. Though there have been some announcements of Canadian expansions, on net announcements are

GLOBAL EXPORT FORECAST – JULY 2008

skewed to the downside. The outlook for prices is similar but with greater weakness showing up in 2009. There is a massive build underway in chemicals production capacity in some emerging markets, led mostly by countries in the Middle East. With products from these facilities starting to hit the global market at the end of this year supply will outpace demand lowering prices for some organic chemicals.

Plastics and rubber manufactures are even more exposed than chemicals to demand-side headwinds, with 92% of total exports going to the US. Moreover, when compared to the chemicals industry, Canada's plastics' companies tend to be smaller and as such can face greater cash flow problems during a US recessions. This may prove particularly true given tight credit market conditions. Moreover, present conditions in US consumer and construction markets will limit any price driven boost to exports. As with chemicals, the plastics industry is seeing a strong buildup of supply in emerging markets. In the case of plastics this is being witnessed mostly in China.

Forestry - Canadian forestry exports will weaken again in 2008, dropping 12%. The decline is largely caused by weaker demand for wood products, but is also the result of production curtailments in the paper industry, and currency effects.

Wood products exports remain on their downward path, driven by the continued decline in demand from the US housing sector. We expect housing starts to bottom out in the second half of 2009, and average 997,000 this year, down 26%. Aggressive curtailments by lumber and oriented strand board (OSB) companies have restored some balance to the market in recent months, but more will be required in the second half to maintain prices at their current levels.

Fibre shortages and higher energy prices will sustain the momentum for pulp prices in the near-term. Global demand has remained strong so far this year, with global shipments up 5.5%. However, demand will weaken in the second half of 2008, with the curtailment of paper capacity in North America and Western Europe. Furthermore, the closure of two BC pulp mills, due to financial difficulties, will result in weaker exports for the remainder of the year.

Exports of paper products will fall 8% in 2008, as higher prices for newsprint and major printing and writing paper grades are offset by numerous capacity closures. These closures were brought forth by the continued decline in paper consumption in North America, exacerbated by the drop in advertising demand. Despite rising prices, higher costs for fibre, energy and transportation, and the Canadian dollar are keeping profit margins slim.

The export outlook for the forestry sector in 2009 is more promising, as EDC expects the dollar and energy prices to ease from their current levels, providing some relief to Canadian exporters. Overall, we maintain our 10% export growth forecast for next year.

Fertilizers – Fertilizer prices surged to record-highs early in 2008, and have continued on a tear since then, sustained by sharp increases in global agricultural and energy prices. As a result of sharper than expected increases in prices for potash, urea and sulphur, EDC has revised its fertilizer export forecast for 2008 upward. We now expect Canadian fertilizer exports to expand 78% in 2008. While the recent spike in food prices may dampen the biofuel expansion drive, it has pushed numerous emerging market governments to increase food production, which will require greater imports of fertilizers. At the same time, supplies will remain limited in the short-term, as global inventories have tightened and significant capacity expansion projects for urea and potash are still a few years away.

Canadian exports of fertilizers are not expected to continue on the growth path of recent years in 2009. With global food and energy prices expected to ease next year, and high fertilizer prices expunging some of the demand, Canadian fertilizer exports will see growth of 3% in 2009.

Services – The surging Canadian dollar and slower US economic growth resulted in weaker services exports in 2007. The outlook for this year is much weaker, as the dollar remains at historically high levels and the US-based downturn spreads through the rest of the world. EDC Economics is projecting minimal growth in overall services exports in 2008. But as the dollar depreciates and a pickup in services demand takes hold, we expect growth of 2% in 2009. Commercial services, which account for more than half of total services exports, are projected to slip by almost 1% this year. Transportation services, which account for about 18%, will remain

GLOBAL EXPORT FORECAST – JULY 2008

steady, well-shy of the pace set in previous years. Travel services, the other main sub-category at 25%, will slip in line with the pace of decline of overall services.

Commercial services, which were hit hard by a broad range of factors last year, can expect another tough year in 2008, as those trends persist. A gentle recovery will take hold next year, driven by rebounds in computer and information, royalties and the financial sub-categories. The global credit crunch, and related collapse of the US housing market, which socked a one-two punch to financial, insurance and construction services, will likely be a factor again this year. R&D, architectural, engineering and audio-visual services, due to their high labour-cost content, also hit troubles that will likely persist this year. But as the Canadian dollar weakens and the US economy begins to recover in 2009, we expect demand for commercial services to recover.

The US accounts for roughly half of all transportation services earnings. After last year's strong performance, exports this year will be hit by a combination of still-high fuel prices, a strong loonie and weaker demand. Indeed, land transportation, which is almost all destined for the US and accounts for 27% of total transportation services, will slip 3% this year, but rebound in 2009. While water transportation services performed well in 2007, significantly weaker outcomes are in store for this year and next. Finally, air transportation will be flat this year, followed by some improvement next year.

Both business and private sector trips are struggling to cope with the rise of the Canadian dollar, and another sub-par year is expected in 2008. Personal travel, which accounts for 82% of receipts, is highly impacted by price. To be sure, travel providers are hard pressed to pass on cost increases at a time when the US dollar does not go as far as it used to. Furthermore, US consumers are sure to cut back on non-essentials, like vacations, in 2008. As consumer confidence returns in 2009, personal travel will begin to recover. Business travel will also remain depressed this year – owing to the fact that businesses tend to implement travel cutbacks as a first line of defence against economic slowdowns. We expect some improvement in 2009.

Other EDC Economics Publications

[Export Performance Monitor](#)

The Export Performance Monitor is a monthly publication which tracks recent movements in Canadian exports by industry and geographic market. The monitor also assesses EDC's main export forecast, which is produced twice yearly.

[Weekly Commodity Price Update](#)

The Commodity Price Update is a weekly report on activity in the principal commodity markets. The report includes commentary on the short-term outlook as well as charts and tables highlighting recent trends.

[Weekly Commentary by Peter G. Hall](#)

Short, intuitive insights into this week's hot economic issue.

Country Snapshots

- [2008/06/01 - Canada Country Overview](#)
- [2008/06/01 – Euro zone Country Overview](#)
- [2008/06/01 - US Country Overview](#)
- [2008/06/01 - Brazil Country Overview](#)
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