

Canada: Int'l merchandise trade (Oct)

Upside surprise where it counts.

The picture on trade in October provided a welcome upside surprise for the Canadian economy with a greater than expected narrowing in the trade deficit. For October, the deficit shrank from September's -C\$2.3bn (revised up from -C\$2.5bn) to -C\$1.7bn. Its a good number and its real. Export volumes in October were rose by 2.9%/m/m while import volumes rose by 1.7%/m/m. Its the best of both worlds. A narrower deficit coming on the back of an overall increase in cross border activity. For a small open economy like Canada's, an active border translates into an active economy.

The facts.

Some seasonality coming through in the numbers with agricultural exports rising by 7.5%/m/m (crude veggie exports jumped 55%/m/m, which boosted the number by C\$100mn). The energy picture continues to confound with total exports down -2.6%/m/m. Crude petroleum exports were up (+2.8%), in that there was no surprise, but what gets forgotten in the Canada story is that natural gas exports are getting stopped up (natural gas exports in October dropped by -14.4%/m/m) by the onslaught of shale gas in the US. Shale gas has upended a significant chunk of the Canadian energy story (Canada used to be as much a natural gas story as it was a crude oil play), having driven prices for natural gas down to rather uneconomical levels for some Canadian producers. So too has the added domestic US supply of shale gas supplanted some of the traditional demand for Canadian product.

Further into the report, copper exports which had plunged in September (-67%/m/m), gave back all that much and more, rising 242.7%/m/m, boosting exports by C\$250mn and contributing significantly to the 13.7%/m/m rise in the export of industrial goods and materials. Although repeating this in November may prove the challenge. Precious metals and alloys also provided a significant boost rising by 45.2%/m/m. In the goods sector, industrial machinery, aerospace and some auto sector components all improved. Overall, auto sector exports are up 3.5%.

Of particular interest is the fact that the improved trade picture came not on the back of a significant pick up in exports into the US (+0.4%/m/m), the traditional destination for Canadian goods, but rather from some unlikely sources, Japan 17.4%/m/m, the EU 15.0%/m/m and "other countries" which would include the high growth EM space, up 8.1%.

On the import side of the equation, machinery and equipment imports are holding in at the recent highs suggesting that business investment remains robust. Energy imports jumped 8.3%

Implications.

In the big picture, the trade data is particularly important. Net trade for the last two quarters has been the albatross around the neck of the Canadian economy, knocking sizeable chunks out of top line GDP growth. Fixing the GDP picture for Canada requires narrowing that net trade gap and moving back toward a position whereby net trade is once again a positive contributor to GDP, facilitating the rolling away from a reliance upon consumer and government demand for growth. From a policy standpoint, today's data brightens the picture on Q4 GDP.

We argue that the BoC is on the horns of a dilemma of sort, confronted by the pressing need to raise the cost of funds with the aim of curbing consumer behavior which is responding to cheap and apparently abundant credit while at the same time wrestling with less than robust top line growth courtesy of the drag associated with trade. Raising rates in response to

unwanted consumer behavior risks complicating the trade picture through a potentially stronger profile on CAD vs its major trading partners. Today's data suggests that Canada is capable of growing exports in the face of a still strong Canadian dollar.

Improved headline growth is conditional upon an improved picture on net trade. And an improved trade picture removes one of the chief event risks to the BoC economic story. While one report does not a trend make, it is none-the-less an important shift in the data profile.

Bottom line.

Today's upside data surprise hit where it counts. Its what Canada needs to see if it is to punch above its weight class and move beyond an economic growth profile that can be at best characterized as incremental.

Disclosure appendix

Analyst certification

The following analyst(s), who is(are) primarily responsible for this document, certifies(y) that the opinion(s), views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Stewart Hall

This document has been prepared and is being distributed by the Research Department of HSBC and is intended solely for the clients of HSBC and is not for publication to other persons, whether through the press or by other means.

This document does not provide individually tailored investment advice and should not be construed as an offer or the solicitation of an offer to buy or sell any securities or to participate in any trading strategy. The information contained within this document is believed to be reliable but we do not guarantee its completeness or accuracy. Any opinions expressed herein are subject to change without notice. HSBC may hold a position in, buy or sell on a principal basis or act as a market maker in any financial instrument discussed herein.

Analyst(s) are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Chinese Wall procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

Additional disclosures

- 1 This report is dated as at 10 December 2010.
- 2 All market data included in this report are dated as at close 10 December 2010, unless otherwise indicated in the report.
- 3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

Disclaimer

* Legal entities as at 31 January 2010

'UAE' HSBC Bank Middle East Limited, Dubai; 'HK' The Hongkong and Shanghai Banking Corporation Limited, Hong Kong; 'TW' HSBC Securities (Taiwan) Corporation Limited; 'CA' HSBC Securities (Canada) Inc, Toronto; HSBC Bank, Paris branch; HSBC France; 'DE' HSBC Trinkaus & Burkhardt AG, Dusseldorf; 000 HSBC Bank (RR), Moscow; 'IN' HSBC Securities and Capital Markets (India) Private Limited, Mumbai; 'JP' HSBC Securities (Japan) Limited, Tokyo; 'EG' HSBC Securities Egypt S.A.E., Cairo; 'CN' HSBC Investment Bank Asia Limited, Beijing Representative Office; The Hongkong and Shanghai Banking Corporation Limited, Singapore branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch; HSBC Securities (South Africa) (Pty) Ltd, Johannesburg; 'GR' HSBC Pantelakis Securities S.A., Athens; HSBC Bank plc, London, Madrid, Milan, Stockholm, Tel Aviv, 'US' HSBC Securities (USA) Inc, New York; HSBC Yatirim Menkul Degerler A.S., Istanbul; HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC, HSBC Bank Brasil S.A. - Banco Múltiple, HSBC Bank Australia Limited, HSBC Bank Argentina S.A., HSBC Saudi Arabia Limited., The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch.

Issuer of report

HSBC Securities (Canada) Inc.
70 York Street, 8th Floor
Toronto, Ontario M5J 1S9, Canada
Telephone +1 416 868 7523
Fax +1 416 364 2543
Website: www.research.hsbc.com

This document has been issued by HSBC Bank Canada, HSBC Securities (Canada) Inc., and/or their affiliates (collectively "HSBC"). The material contained in this document is for the information of clients of HSBC and is not for publication to other persons, whether through the press or by other means. Unless otherwise stated, any pricing information given in this document is indicative only, is subject to change and does not constitute an offer to buy or sell any securities, currency or related financial instrument at any price quoted. HSBC is not liable for any errors or omissions in the content or transmission of this email. Where this document contains market updates/overviews, or similar materials (collectively deemed "Commentary" in Canada although other affiliate jurisdictions may term "Commentary" as either "macro-research" or "research"), the Commentary is not an offer to sell, or a solicitation of an offer to sell or subscribe for, any currency or related instrument. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient in the preparation of the Commentary. The Commentary is derived from sources HSBC believes to be reliable but which HSBC has not independently verified. No representation or warranty is made with respect to the completeness or accuracy of the Commentary. HSBC, its affiliates, their directors, officers, employees and agents: (1) are not liable for any direct or consequential loss arising from use of or reliance on the Commentary, and (2) may have a long or short position in, or otherwise participate in markets for, the currencies and securities mentioned in the Commentary.

This document may be distributed in the United States solely to "Major US Institutional Investors" (as defined in Rule 15a-6 of the US Securities Exchange Act of 1934); such recipients should note that any transactions effected on their behalf will be undertaken through HSBC Securities (USA) Inc. in the United States. In Singapore, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch for the general information of institutional investors or other persons specified in Sections 274 and 304 of the Securities and Futures Act (Chapter 289) ("SFA") and accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the SFA. This publication is not a prospectus as defined in the SFA. It may not be further distributed in whole or in part for any purpose. The Hongkong and Shanghai Banking Corporation Limited Singapore Branch is regulated by the Monetary Authority of Singapore. Recipients in Singapore should contact a "Hongkong and Shanghai Banking Corporation Limited, Singapore Branch" representative in respect of any matters arising from, or in connection with this report. In Hong Kong, this document has been distributed by The Hongkong and Shanghai Banking Corporation Limited in the conduct of its Hong Kong regulated business for the information of its institutional and professional customers; it is not intended for and should not be distributed to retail customers in Hong Kong. The Hongkong and Shanghai Banking Corporation Limited makes no representations that the products or services mentioned in this document are available to persons in Hong Kong or are necessarily suitable for any particular person or appropriate in accordance with local law. All inquiries by such recipients must be directed to The Hongkong and Shanghai Banking Corporation Limited. In Korea, this publication is distributed by either The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch ("HBAP SLS") or The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch ("HBAP SEL") for the general information of professional investors specified in Article 9 of the Financial Investment Services and Capital Markets Act ("FSCMA"). This publication is not a prospectus as defined in the FSCMA. It may not be further distributed in whole or in part for any purpose. Both HBAP SLS and HBAP SEL are regulated by the Financial Services Commission and the Financial Supervisory Service of Korea. In the UK this report may only be distributed to persons of a kind described in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001. The protections afforded by the UK regulatory regime are available only to those dealing with a representative of HSBC Bank plc in the UK. HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC is authorized and regulated by Secretaría de Hacienda y Crédito Público and Comisión Nacional Bancaria y de Valores (CNBV). HSBC Bank (Panama) S.A. is regulated by Superintendencia de Bancos de Panama. Banco HSBC Honduras S.A. is regulated by Comisión Nacional de Bancos y Seguros (CNBS). Banco HSBC Salvadoreño, S.A. is regulated by Superintendencia del Sistema Financiero (SSF). HSBC Colombia S.A. is regulated by Superintendencia Financiera de Colombia. Banco HSBC Costa Rica S.A. is supervised by Superintendencia General de Entidades Financieras (SUGEF). Banistmo Nicaragua, S.A. is authorized and regulated by Superintendencia de Bancos y de Otras Instituciones Financieras (SIBOIF). In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (AFSL No. 232595). These respective entities make no representations that the products or services mentioned in this document are available to persons in Australia or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. This publication is distributed in New Zealand by The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch.

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of HSBC Securities (Canada) Inc. HSBC Securities (Canada) Inc. is a wholly owned subsidiary of, but separate entity from, HSBC Bank Canada. Member CIPF. ©Copyright 2010. MICA (P) 142/06/2010 and MICA (P) 193/04/2010