Canada

Coming up trumps on trade, but overall its a weak hand.

Canada's net trade deficit narrowed dramatically in November, declining from a revised -C$1.5bn (C$200mn net adjustment) to just -C$0.1bn. An outcome well ahead of the median at -C$2.0bn and our own more optimistic at -C $1.4bn. Although not all is coming up trumps for Canada. True the headline trade deficit tightened beautifully, but unfortunately the improved picture was largely due to an incremental increase in exports of 0.8% only, combined with a large 3.2% slide in imports. For a small open economy like Canada's, an active border signals and active economy, and the border was not all that active.

The Facts.
In terms of volumes, import volumes cascaded lower declining by 2.4%m/m while export volumes fell 2.0%m/m.

The biggest dollar contribution to exports in November came out of the industrial goods and materials sector (think metals) that jumped by 6.6%m/m, of which just slightly less than 4% is attributable to higher prices. On a percentage basis, consumer goods exports posted biggest gain, growing by 11.5%m/m. Out of the energy sector, overall exports were up 3.2%. We had expected big gains out of energy, in this case led by crude. What was unexpected was the -17%m/m plunge in natural gas exports. That said, there is room for recovery here in December as temperatures in the North East plunged well below seasonal norms.

Other areas of interest, an unexpected 10.4% collapse in auto exports (passenger automobiles and chassis exports fell 13%). This surprised us given all of the anecdotal evidence suggesting that Canadian auto producers were turning out vehicle lines that were meeting with good demand out of the North American consumer. That said, there seems to be again good reason to see this picture turn around in December. Front and centre, December's employment report reflected a very large increase in hiring out of Ontario manufacturers where the auto sector is based. Another major transitory factor in the story as Statcan points out, was a drop in auto imports into Canada (-6.3%) the result of plant shut downs as they retooled for the 2011 vehicle line up.

For imports, declines were centred on a -15% drop in energy and a -5.1% decline in machinery and equipment. For an economy that is supposed to be retooling, the decline in machinery imports is unwelcome.

Implications.
The improved picture on net trade will drill directly into the bottom line for GDP. The steady tightening in the trade deficit for both October and November suggests that there is some decent upside that can be attached to the forth quarter GDP. Indeed, if we are correct and those areas of the report that weighed heavily on exports (natural gas and autos) correct in the December report, there is a compelling growth story for the final quarter of 2010. And with it some further support for our call looking at a March rate hike.

The importance of the trade picture to the overall Canadian economic story should not be underestimated given the significant drag associated with the trade deficit. Moving beyond the incremental rates of growth that have been plaguing the Canadian economy for the last couple of quarters necessitates reducing the net drag associated with trade.

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Bottom Line.

Its a terrific print on the headline but the underlying story reflects some softness; i.e. trade volumes are lower. Still, at first blush, our inclination is to view the December numbers more favorably with the expectation for a significant reversal in the declines recorded in November for auto and natural gas exports.

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Disclosure appendix

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2 All market data included in this report are dated as at close 13 January 2011, unless otherwise indicated in the report.

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