

## Canadian Trade Showcases Investment Retreat

### Canada, International Merchandise Trade Balance, C\$ Billions, October:

Actual: -1.47

Scotia: -2.5

Consensus: -2.7

Prior: -3.36 (revised from -3.18)

- Canada registered a narrower monthly trade deficit in value terms partly through stronger exports but also due to a heavy role played by a plunge in imports. Some of that drop in imports was due to transitory factors in the auto sector but the breadth of the import decline and what the details say about business investment in particular suggest that much of the weakness reflected a weakening pull effect by the domestic economy on imports. Hence the trade figures pose somewhat of a conundrum to the BoC in that exports improved but not by enough to materially move the needle on export tracking in Q4 after Q3's plunge and that's not good enough anyway if the signal is a softening domestic economy. The broad trade picture settles out in terms of needing more data, but I think the BoC will particularly focus upon a potential stalling out on the investment side of the picture.
- Since Canada imports the majority of its capital goods, the leading indicator for investment spending comes from the import figures. Imports of industrial machinery fell by 1.9% m/m in value terms and declined for the third time in four months. They are tracking a 7% q/q annualized decline in Q4 after a 4% drop in Q2. Imports of electrical equipment were flat (+0.2% m/m) after declining for three consecutive months and four of the past six months. **Elevated investment intentions are being signalled by the BoC in its BOS survey which is a very limited sample of business opinions and that survey may be dated in the face of the intensification of NAFTA risks from October onward. By contrast, the evidence at the margin through hard data is signalling that the exact opposite is happening as investment retreats.** That's rational to me as businesses can't be blamed for being more guarded toward investing millions or billions into new projects when the rules of the trade and investment regime are potentially up in the air. Now to the extent to which the investment cycle is connected to hiring...
- Export volumes were up 1.2% m/m in aggregate and marked by solid breadth while import volumes fell by 3.9% m/m.
- The decline in imports was significantly but not solely driven by autos and parts. In value terms, seven of eleven import categories fell which signals decent breadth by way of the softness. In dollar terms, imports of autos and parts were down 8.1% m/m and imports of passenger cars and light trucks fell by 8.8%.
- The drop in autos and parts explained half of the weakness in import volumes. I would look through most of that due to work stoppages and planned shutdowns as that component will likely rebound going forward. I would not look through the other half.
- **Export volumes are tracking a small gain of under 2% q/q at an annualized and seasonally adjusted rate in Q4 based upon the hand-off from Q3 and October. That follows a 13% retreat in Q2 and so it's hardly compelling evidence that exports are bouncing back after a big contraction.**

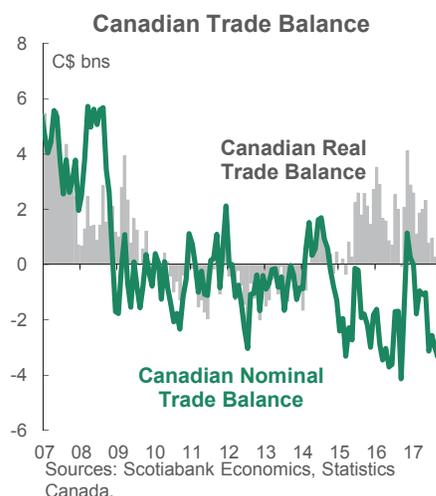
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- **Import volumes are tracking a 10% q/q decline in Q4 after a 2% decline in Q3.** The durability of the weakness and the drivers beyond autos suggest a) don't look through the soft patch and try to explain it away, and b) treat it as a partial reflection of domestic economic weakness.
- In value terms, exports were up 2.7% m/m. Exports were up in 9 of eleven major categories with the exceptions being metal ores and non-metallic minerals (-4.8% m/m) and aircraft and other transportation (-7.7%).

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