Canadian Trade Reinforces BoC Hike Expectations

Canada, International Merchandise Trade Balance, C$ Billions, June:

Actual: -0.63

Scotia: -2.0

Consensus: -2.3

Prior: (unrevised from -2.77)

- The Canadian dollar appreciated to under 1.30 on a USDCAD basis and short-term yields rose slightly in the wake of considerably stronger than expected trade figures for June. At the margin, while the figures have some distortions such as in the oil patch, they confirm that Canada is capturing some of the benefits of stronger US growth but also that the rebound in cap-ex activity that is driven by an economy that has slipped into mild excess aggregate demand conditions is driving a complementary improvement in exports (more below). Data speaks louder than NAFTA negotiations. The figures incrementally reinforce our expectations for a BoC rate hike on September 5th. While there always subject to revision, I'm frankly amazed that the trade deficit narrowed as much as it did after going to the most optimistic end of the range of consensus estimates.
- As the two accompanying charts depict, both sides of the trade ledger have witnessed sharp improvements to volumes over time.
- CDN export volumes are up by almost 16% q/q SAAR in Q2 after a 4% rise in Q1. Import volumes were up by 7% in each of Q1 and Q2. That indicates very solid domestic and external strengths. Canada is getting explosive trade gains despite monotonous never ending NAFTA negotiations. I think the dominant factors are spillover from US growth and the cap-ex cycle in Canada that has turned much more favourably. By expanding capacity as the economy goes into excess aggregate demand, the cap-ex cycle is driving the complementary pick-up in trade. That's exactly what Governor Poloz has long wanted to see as it indicates a virtuous self-reinforcing dynamic between trade and investment.
- Export volumes were up by 2% m/m in June which reverses the 2% slide in April. Before you dismiss the two-month flat trend, I would instead suggest looking at the trend that has witnessed solid gains in export volumes in four of the past five months. June partly occurred because of reversals to distortions in the May report, but not exclusively, and the trend is your friend here. Poloz dismisses individual point estimates as the 'bumps and wiggles' but he won't disregard the quarterly trends that are indicating a rapid acceleration of export gains.
- Import volumes fell by 1.3% m/m but here we have the opposite to the export side of the monthly volatility. Recall that in May, import volumes climbed by 1.4% m/m and so June just reverses that. Import volumes have increased in three of the past five months.
- Breadth was more solid than headlines indicating a narrow concentration upon oil and aircraft exports. 8 of 11 export categories advanced. 8 of eleven import categories also advanced.
- On a regional basis, export growth was the strongest in markets beyond the US. Exports to Germany were up 41% m/m, and there were big gains in exports to France (+46%), Italy (+19%), Mexico (+16%), Japan (+5%) and exports to the US lagged at +2.5% m/m.

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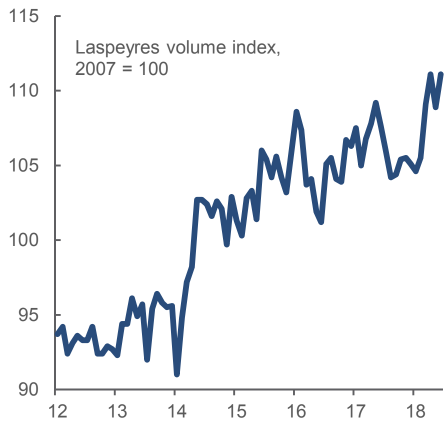
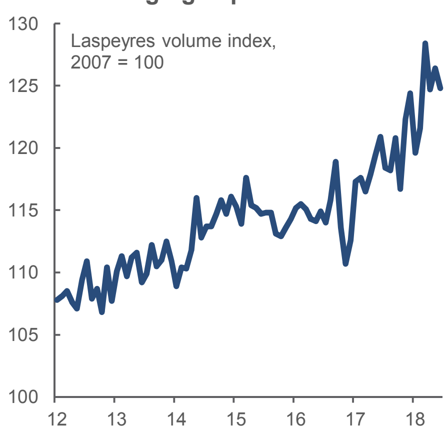
Export Volumes Tearing Higher



Sources: Scotiabank Economics, Statistics Canada.

Surging Import Volumes



Sources: Scotiabank Economics, Statistics Canada.